ESSAYS IN TAXATION

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ESSAYS IN TAXATION

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PREFACE TO THE TENTH EDITION

THE changes in this tenth edition, which appears after an interval of almost four years, although not so numerous or so important as in the preceding edition, are nevertheless of some significance. Advantage has been taken of the opportunity to bring the discussion of the literature throughout down to date and to call attention to the most recent development of the different problems. This applies especially to the chapters on double taxation, on the inheritance tax, and on the taxation of corporations. Various minor errors and misprints have also been corrected.

EDWIN R. A. SELIGMAN.

COLUMBIA UNIVERSITY,
May, 1925.

FROM THE PREFACE TO THE NINTH EDITION

THE well-nigh nine years that have elapsed since the last complete rewriting of this book have witnessed not only the Great War but important changes in state and local taxation here and abroad. Advantage has therefore been taken of this edition not only to bring the various chapters down to date but to add five new chapters, three of which are directly the outcome of the war discussion. In order to make room for these, the three chapters devoted to American Reports on Taxation have been compressed into one, although continued down to date. In the body of the book an attempt has been made to take account not only of the changes in legislation, but also of the recent discussions in fiscal science.

E. R. A. S.

COLUMBIA UNIVERSITY,
August, 1921.

FROM THE PREFACE TO THE EIGHTH EDITION

THIS book was originally published in 1895, and the favor with which it was received has rendered necessary a new edition every two or three years. Owing partly to the pressure of other occupations and partly to a shrinking from the arduous labor which would have been required to keep the presentation up to date, these successive editions contained but slight changes. Now however, after the lapse of almost eighteen years, the progress of the world, both in fiscal facts and in economic theory, has been so marked as to render any further delay impossible if the book is to remain a half-way satisfactory interpretation of actual conditions.

I therefore determined to subject the volume to a careful revision and, where necessary, to rewrite entire sections or even chapters. Moreover, in the interval, not a few of my addresses and articles on germane topics have appeared; and it seemed opportune to incorporate a selection from these into the book, even at the risk of some inevitable repetition in a few pages here and there. As a consequence, the thirteen chapters of the earlier editions have grown to twenty-one; and this together with the additions to the remainder of the work has resulted in a volume of almost double the size of the original. To a large extent, therefore, the present edition may be regarded as a substantially new work.

E. R. A. S.

COLUMBIA UNIVERSITY, NEW YORK,
March, 1913.

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ESSAYS IN TAXATION

CHAPTER I

THE DEVELOPMENT OF TAXATION

To the citizen of the modern state, taxation, however disagreeable it may be, seems natural. It is difficult to realize that it is essentially a recent growth and that it marks a comparatively late stage in the development of public revenue; it is more difficult to realize that each age has its own system of public revenue, and that the taxes of to-day are different from those of former times; it is still more difficult to perceive that our ideals of justice in taxation change with the alteration in social conditions. Not only the actual forms of taxation, but the theories of taxation as well, vary with the economic basis of society. Fiscal conditions are always an outcome of economic relations. This is true even where the direct influence of political causes is traceable, for political changes are in the last resort dependent on economic changes. Finance and economics are inextricably intertwined. Like all the facts of social life, taxation itself is only an historical category.

I. *Voluntary and Compulsory Payments*

At the beginning of history there is no such thing as a state. Whether we accept Hobbes' theory of the *bellum omnium contra omnes,* or the more modern clan theory of the origin of society, there is no public household, because there are no recognized public needs. But even in the original man there are possibilities of social development. Man, as Aristotle tells us, is a social and political animal. Centuries of hard experience strengthen the social instinct and contribute to form primitive society, until finally a real political life emerges.

Gradually from either physical, ethical or religious causes a leader evolves. The oldest or the wisest or the bravest—at all events, the one possessed of some peculiar character-

istic—becomes the leader of the horde, the clan or the tribe. He acts as the great priest, great judge or great warrior, often combining all three qualities. There are no financial needs, because the only consideration is that of defence; and every man contributes to the defence in his own person. The leader himself subsists on the booty of war.

But with the growth of society and the expansion of the clan into the larger community, the public needs develop. Administration begins. Roads, bridges and fortifications are constructed, and the prince or king must now not only maintain order, but must be assured of a revenue to support his household and to distribute favors to his retinue. All his followers, being roughly equal, now support him by gifts, whether of labor or of property. In all primitive societies voluntary offerings constitute the first form of common contributions, and every man feels the necessity of upholding the political and military organization by his own personal efforts.

The king's needs now increase. They are chiefly personal needs, except in so far as expenditures are made for the purposes of internal peace and external defence. But in order to ensure his position, the king endeavors to secure his revenues elsewhere. He develops the subsidies and tributes of the allied and conquered nations, and amasses treasure filched from abroad. Part of this he distributes among his followers; part he retains to increase his own possessions. The private property of the king differentiates itself from the public property, which was originally common to all. The monarch now increases his revenues and domains through the acquisition of lucrative prerogatives of all kinds. Certain activities come to be looked upon as within his peculiar province. The king's peace must be kept—any infraction must be paid for in fines and penalties; not only crimes, but torts, have their public side. Nobody can harm an individual without breaking the king's peace, and having to pay for it. Commerce begins, and weights and measures and money are needed. The royal rights of coinage arise; and as the kingship becomes stronger, the rights of escheat, of wreck, of confiscation develop, until finally the various royal prerogatives bring in a substantial revenue.

Voluntary payments have in the meantime ceased. As society advances, what was at the outset freely given comes to be paid by the individual from a sense of moral obligation. But with the weakness of human nature, in the face of a diver-

sity of interests, even the feeling of duty soon fails to produce an adequate revenue. The moral obligation slowly becomes a legal obligation, keeping pace with the crystallization of social usage and custom into primitive law; the voluntary offerings become compulsory contributions. But the compulsory contributions are still largely personal services, connected with the common security. Such was the early mediæval *trinoda necessitas*, the liability to military service, to watch and ward, and to the repair of the bridges and fortifications. The first forced contribution of the individual to the maintenance of the common welfare is always seen in this rude attempt to assess every one according to his ability to bear the common burden—his faculty. This faculty consists in the enforced participation in the administration. But there is not yet any idea of taxation of property. The contribution is personal, and is limited to a few well-defined objects. The individual's faculty is found in his person, not in his property, because there is practically no private property. And the contributions are, for the most part, not regular, but spasmodic.

As civilization gradually advances, private property develops, and the primitive equality slowly disappears. The interchange of commodities takes place on a larger scale. The old revenues are no longer adequate, and it becomes necessary for the monarch to supplement them by broadening the field of these compulsory contributions of service. In other words, the need of taxation arises. But a direct tax is still out of the question. Public opinion will not yet admit its necessity. The taxation of property is scarcely less impossible than the taxation of the person. It is regarded as a badge of disgrace for the freeman—a *nota captivitatis*, as the Romans at first called it—because only conquered enemies have to pay this arbitrary impost. The king, therefore, must endeavor to effect his object covertly. He must go to work in a roundabout way, and hide the tax in a variety of disguises. He either gradually extends his lucrative prerogatives, or alleges that the charges are simple returns for governmental services. He grants protection or privileges to individuals, and requires some payment in return. Thus begins the period of fees and charges, which the individuals are willing to pay and which gradually reconcile the public to the idea of governmental charges.

Before long, however, the monarch feels able to throw off all disguises, and limits the amount of his exactions only by the de-

gree of his rapacity. Thus the fees and tolls change into taxes on exchange and transportation; thus the people become accustomed to the "customs"; thus the "evil duties" and the excises grow apace; thus the payments become veritable "impositions." In other words, the community enters upon the stage of indirect taxation.

This explains why it is so difficult for the idea of direct taxation to force its way into popular favor. The earliest manifestations of the taxing power are generally merciless and brutal. They are apt to react on the public consciousness and to stunt the growth of any feeling of obligation. It is not until public morality has so far developed as to introduce more lenient and more refined processes of indirect taxation that we discover a growing willingness on the part of the individual to pay direct taxes. Another reason for the later appearance of direct taxation is that the indirect taxes are often paid without the contributors being really conscious of it. They are jealous of their own and not public-spirited. They are willing to give only that the loss of which they do not feel. But whatever be the reason, it is clear that when this final stage—possible only after centuries of laborious and continued exertion—has been reached, we enter upon a new phase in the history of finance. The readiness to share in the public burdens out of one's property presupposes a far higher social ethics and a far more complex society than was possible in the simple conditions when every one was willing to take part in the defence of the village or the repair of the roads. Interests have now become specialized. It needs a far greater sense of civic obligation to submit cheerfully to direct property taxation than was necessary in primitive times for the putting forth of mere personal exertions. Even to-day the full import of this obligation is only inadequately grasped. Until within a few years it was deemed necessary to base the theoretical justification of taxation on fanciful doctrines of contract, of protection and the like. And even at the present time, those who cheerfully seek to contribute their share to the common burden form the exception, not the rule. But even the imperfect recognition of this duty implies a highly developed political consciousness. The method of taxing every one according to his property is the first rough attempt of a property-owning community (as over against a primitive community) to assess each member according to his relative ability. The introduction of the direct

property tax is a vast step forward in the development of social ethics.

This historical process is well illustrated by etymology. If we look at the various terms applied to what we to-day call a tax, we shall find every shade of the development reflected not only in the words used in former centuries, but in those still employed to-day. There are no less than seven different stages in this etymological growth.

The original idea was that of gift. The individual made a present to the government. We see this in the mediæval Latin term *donum* and in the English *benevolence*, which was used far into the middle ages. The second stage was reached when the government humbly implored or prayed the people for support. This is the meaning of the Latin *precarium*, used for many centuries on the continent, as well as of the German *Bede* (from *beten*, to pray). The *Landbede* was the term applied to the land tax in the German states until quite recently. With the third stage we come to the idea of assistance to the state. The individual felt that, if not making a gift, he was at least doing the government a favor. This idea is expressed in the Latin *adjutorium*, the English *aid* and the French *aide*, which was at one time used for all kinds of taxes. The same idea is discernible in the English *subsidy* and *contribution*. It has survived in the German term for a tax, *Steuer* (*steuern*, to help), and in the Scandinavian *hjelp*. In France *contribution* is even to-day commonly used as synonymous with tax.

The fourth stage of development brings out the idea of sacrifice by the individual in the interest of the state. He now surrenders something for the public good. This is seen in the old French *gabelle*, in the modern German *Abgabe*, and in the familiar Italian *dazio*. In each case the citizen gives or sacrifices something. With the fifth stage the feeling of obligation develops in the taxpayer. The English *duty* was not originally restricted to its present narrow meaning in the United States. Here it is usually applied to import taxes and sometimes to the internal revenue taxes. But even to-day in England the term includes some of the most important so-called direct taxes, like the inheritance tax and the income tax. It is not until the sixth stage is reached that we meet the idea of compulsion on the part of the state. We see this in our *impost* or *imposition*, as well as in the French *impôt* and the Italian *imposta*. Although we limit the term to a certain kind of tax, the French use it

as the generic epithet *par excellence*. The same idea is seen in the German *Auflage* (something "laid on") and *Aufschlag* (something "clapped on"), frequently used at present for certain indirect charges on commodities.

With the seventh and final stage we reach the idea of a rate or assessment, fixed or estimated by the government without any reference to the volition of the taxpayer. We see this in the mediæval English *scot* (to be "at scot and lot"), which is nothing but the German *Schoss* or the Scandinavian *skatt*. It is seen in the German *Schätzung* (or estimate), which was used until about a century ago. Above all, it is recognized in our *tax* (*taxare*, to fix, to estimate), the French *taxe*, the Italian *tassa* and the English *rate*. It is worthy of note that in the middle ages "tax" always meant a direct tax, for which a regular assessment list or schedule was made.

II. *Direct versus Indirect Taxation*

With the introduction of direct taxation, the progressive increase of public revenues becomes far easier. This is fortunate, for with the advance of civilization the public expenditures grow apace. For a long time, as we have seen, almost the only aims of government are security and defence. But as economic conditions develop and various classes of society differentiate, more attention must be paid to matters of general welfare. Expenditures for commerce, industry and transportation arise. The need is felt for better roads, for more canals, for improved methods of communication through the postal service. Then the less material ends of government are recognized. Education must be provided, hospitals and asylums must be erected, and the sanitary conditions must be looked after. Finally comes the immense growth of the modern state, with its new functions due partly to the industrial revolution, partly to the growth of democracy, partly to the recognition in legislation of the preventive as against the repressive principle. These new functions mean fresh expenditures; and these expenditures mean increased taxes. Thus the characteristic mark of the modern age is taxation as against the more or less self-sufficing public economy of former times.

Direct taxation, as we have seen, generally forms the last step in the historical development of public revenues. At first regarded entirely as an extraordinary means of support, it gradually assumes the character of an ordinary form of

revenue. In the early days of classic antiquity the direct tax was used only in very exceptional exigencies and was, in fact, regarded as a compulsory loan, to be repaid in the future. It was not until after the establishment of the Roman Empire, for instance, that the regular direct taxation of Roman citizens began. And the same process may be observed throughout the history of many mediæval states down to the most recent period of European and American history.

In some cases, however, this historical process assumes a slightly different form. It depends entirely on the economic conditions and on the relative importance of the various social classes. For instance, it is incontrovertible that certain kinds of indirect payments always come first, as has been explained above. But when the people understand that indirect charges on commodities increase their price and thus form veritable taxes, it sometimes happens that more opposition is shown to indirect than to direct taxation. In such cases direct taxes furnish the ordinary revenue, and it is only after a severe struggle that indirect taxes are introduced.

This process can be clearly traced in the history of mediæval and modern revenue. In democratic communities, where the legislation is influenced by the mass of the people, we commonly discern a tendency to oppose indirect taxes on consumption. In the early mediæval towns the democratic instincts were strong, because of the more equal distribution of property. We accordingly find that the revenue system was based largely on direct payments, and that the populace rebelled against indirect imposts. But on the continent, where aristocratic influences gradually became powerful enough to break down the communal liberty and democracy, the mass of the people were ground down by taxes on the necessaries of life, while the wealthier or governing classes practically escaped. When the democratic upheaval took place, as in the Italian towns, we find an attempt to reintroduce the old order of things and to reach the wealthy by a system of direct taxes. But with the downfall of the mediæval democracy, the property and income taxes disappeared, while the *octroi* and municipal indirect taxes again came to the front. Only in England, where the democratic instincts maintained themselves somewhat more strongly, and where the power of the aristocracy was held in check by a strong monarchy, do we find continued opposition to the general excises and to local taxes on the necessaries of life. It was with

the greatest difficulty that the excise system was introduced. And the same feeling was awakened under similar conditions on the other side of the Atlantic, when Hamilton initiated his system of indirect taxation or internal revenue in the federal fiscal system of the United States. "The time will come," said one of the members of Congress in 1790, "when the poor man will not be able to wash his shirt without paying a tax." With the advent of the modern democratic state, we notice the same tendency. Indirect taxes, says Lassalle, are taxes on labor. Hence the efforts of modern democracy in England, in Switzerland and in America to confine indirect taxes on consumption and exchange within the narrowest limits.

On the other hand, there is a counter-tendency which has frequently been overlooked. Curious as it may seem, indirect taxes were advocated in the later middle ages as the means of introducing not inequality, but equality, of taxation. This was owing to the fact that the privileged classes on the continent had succeeded in securing virtual immunity from taxation. The nobles were largely exempted from the land tax, while the clergy and the wealthier citizens in general were able to a large degree to purchase freedom from the tax burdens. What was more natural than that the statesmen and tax reformers should attempt to make them pay something through taxes on their expenditure, which they could not well escape? Their plan, it is true, no longer took the shape simply of taxes on the necessaries of life; it was now expanded into the single tax on all expense which would reach the rich as well as the poor. This was the idea of Colbert; and it has been the idea from the time of Hobbes and Petty of all enthusiasts for indirect taxation in England, and of many writers in Germany, in France and in Italy. To-day we are clamoring for the abolition of indirect taxation; formerly the reformers clamored for a single universal indirect tax. The explanation, as we see, is simple.

But this does not yet answer the question why excise taxes were actually introduced into England, as elsewhere, in the seventeenth century. The fact is that tax reformers cannot do much good if economic conditions are not ripe for their proposals. It must be confessed that according to the experience of history most reforms, in finance at least, are due to selfish reasons; they are the necessary outcome of changes in economic relations and of the efforts of each class, whether it be the small or the large class, to gain some advantage for itself. The classic

home of the excise tax or indirect tax on business and trade is Holland. It is well known that Holland, during the sixteenth and seventeenth centuries, had become the leading financial and trading nation of Europe. In the other countries wealth was still centered in the landed interests, and the whole system of taxation was largely dominated by feudal aristocratic ideas. The direct taxes were land taxes, because wealth consisted chiefly of land; but the landed proprietors sought to escape the burden by assessing real property as low as possible and by putting taxes on the necessaries of life of the poorer classes. In Holland, on the other hand, wealth was now largely centered in the moneyed interest. The great traders and merchants did not relish any direct taxation of trading capital, and therefore devised a system of indirect taxation of business which would, as they thought and hoped, be shifted to the community in general, and to the poorer classes in particular. Thus developed the stamp taxes, the excise taxes, and the whole host of indirect taxes for which Holland was noted.

The seventeenth century marks the rise of the trading class in England; "the glorious revolution" was a revolution not so much of the people as of what the Socialists love to call the "bourgeois." Puritanism and commercialism went hand in hand,[1] and the downfall of the Stuarts not only put an end to feudalism, but weakened the fiscal ascendency of the landowner—an ascendency to which another serious blow was given by the abolition of the Corn Laws, and whose final overthrow in England, as elsewhere, is fast approaching. The indirect taxes of the seventeenth century were thus the outgrowth of the effort on the part of the commercial classes to escape the burdens which the landowners were desirous of placing on them. The selfish designs of the capitalists and the unselfish ideas of the tax reformers went hand in hand to widen the scope of indirect taxes. And as the trading class developed in the other countries, the system of excise spread with it.[2] It was not until the

[1] This aspect of Puritanism has more recently been studied in detail by Professor Max Weber in a series of suggestive articles "Die protestantische Ethik und der 'Geist' des Kapitalismus" in the *Archiv für Socialwissenschaft und Sozialpolitik*, vols. xx and xxi (1905).

[2] A word may be said, in passing, about our present attitude toward indirect taxes. There is a prodigious amount of cant on this topic. Many thinkers are apt to make common cause with the socialists and the single-taxers in demanding the complete abolition of the so-called indirect taxes. This is a mistake. There is nothing inherently bad about an indirect tax,

democratic movement of the nineteenth century, when the system of excises was recognized as a burden on the poorer classes, that the number of commodities subject to excise was gradually reduced.

III. *The Forms of Direct Taxation*

We have seen the economic relations which condition the interworking of direct and indirect taxation. Let us now endeavor to learn how these economic conditions affect the growth of direct taxation itself.

In primitive society, there is a certain rough equality in the personal status and the personal abilities of the individual. Hence the idea of the poll or capitation tax, which is the first rude manifestation of the equities of taxation. The members of a club to-day pay equal dues, because their interests are supposed to be equal. Club life does not cover the whole of human activity, but only a very small portion of it. So, in the same way, as long as economic conditions are primitive, the social obligations of the members of the clan or the state are conceived to be equal. But as the social conscience develops, more stress is laid on other elements of ability to pay than on mere number. Not only do men differ in strength, in mental vigor and in opportunities, but inequality of possessions grows greater. And with differences in property, the old feeling of equal obligation weakens. The poll tax becomes unjust and is gradually abolished. A certain phase of this primitive feeling sometimes persists for a long time, especially in democracies where political equality is still based on the fiction of economic equality. We find poll taxes as adjuncts to other taxes long after the justification of a single poll tax has disappeared. But it has now assumed a political significance, as in Switzerland, and in some of the American commonwealths, where its payment is made a condition of the suffrage. Even this tends to become a farce to the extent that the payment of the tax is

nor is there anything inherently good about a direct tax. It depends entirely upon what kind of direct or indirect tax it is. A direct tax on the laborer is not necessarily good because it is direct; an indirect tax on the luxury of the rich is not necessarily bad because it is indirect. It happens, indeed, that most of the indirect taxes of the past have been devised by the powerful in order that their burden might fall on the weak; but it is by no means impossible to frame a system of taxes on consumption which will supplement other taxes and do substantial justice to all. The elaboration of this point must be reserved for another place.

assumed by the political parties. The economic basis of the poll tax has entirely vanished and it tends to be replaced by the property tax.

The first property taxes are entirely in harmony with the facts of early industrial life. It is a matter of common knowledge that the early period of almost every civilization is marked by two chief facts, the preponderance of agriculture and the existence of slavery. As Rodbertus has pointed out,[1] this leads to a fundamental distinction between ancient and modern economic theories. In modern civilization we have not only a quantitative division in wealth, but also a qualitative difference. That is, not only are there rich and poor, but there are landowners, capitalists, employers and laborers. In early civilization there was a quantitative but no qualitative distinction in wealth. Property consisted chiefly of land and the landowner's household, including slaves and beasts of burden. There was no important capital—or at all events, no industrial capital—apart from this landed property, and hence there were no distinct shares in distribution. But Rodbertus errs in predicating of Greece in general and designating by the Greek name an economic system which is characteristic of all early civilizations. It was as true of the slave-holding states in the American Union, and of the mediæval manorial system, as it was of the early Hellenic civilization. Wherever we find only agriculture and slavery, there we have this inseparable mass of collective property, not yet split up into its constituent parts.

The importance of this for finance lies here: since we have only this general collective property, and since this property consists practically of land and the means to till the land, the direct property tax must take the shape either of the land tax or of the tax on the cattle or slaves or implements used in agriculture. These are practically tantamount to each other. For the produce of two given portions of land will vary about in proportion to the value of the land, together with the amount of slaves and cattle necessary to till it. Everywhere at first, therefore, the direct property tax is found to be either the land tax or the tax on agricultural capital.[2] It is the only practi-

[1] "Untersuchungen auf dem Gebiete der Nationalökonomie des klassischen Alterthums," in Hildebrand's *Jahrbücher für Nationalökonomie und Statistik*, iv., p. 343 *et seq.*

[2] In some of the early mediæval tax systems, these were specifically termed cattle and land taxes. So the *Vieh-und Klauensteuer* in Germany.

cable and the only just form of taxation at this early period.

It is, however, important to notice that the property which is now taxed is not so much property in land as property in the produce of land. Whether we have the primitive village community or only the system of common cultivation, the earliest private property consists of the produce of the soil. The first attempt, therefore, to take account of the gradations in the tax-paying ability of the individual is seen in the tax on gross produce—the tithe or any other portion of the produce, or on mere quantity of the land irrespective of value. Since land itself is not private property, since land is not bought or sold, the faculty of the taxpayer can be measured not by the value of the land, but by the value of its produce, which is in some proportion to the quantity of the land. Moreover, in early agriculture, where tilling is extensive and where expenses of cultivation vary but little, the tax on gross produce is a fairly accurate test of ability to pay.

With the advance in population and the necessity of more intensive agricultural methods, owing to the decay of the primitive communal system and the growth of private property in land, it becomes possible to measure the productivity of land in terms of property. Thus the land taxes of this newer stage of culture are property taxes, even though the value of the property is fixed sometimes according to selling value, sometimes according to arbitrary estimates of quality. But where the survivals of primitive conditions are strong, the value is still measured in terms of yield or produce, either actual or computed. In the early middle ages, for instance, land taxes were not based directly on the selling value, because, although land was private property, it was not bought or sold. The lands had rental value, but no selling value, and the tax was assessed not so much on the market value as on the produce of land. When the American colonies were founded, private property in land was well established and the land taxes there very soon became property taxes, although we not infrequently find examples of the taxation of gross produce rather than of property.[1] With the progress of cultivation and the advance in population, the tax on gross produce is supplanted by the property tax on market value.

[1] For details see the article on "Income Taxes in the American Colonies," *Political Science Quarterly*, vol. x. (1895), pp. 233, 234. This is reprinted in Seligman, *The Income Tax*, 1911, part ii, chap. i.

But now comes a change in the forms of economic life—a change that inevitably produces an effect on the public conscience and on the accepted ideas of justice. In the first place, with increasing prosperity we find a gradual increase in the simpler kinds of personal property. The landowner's family gradually accumulates money, clothing, and luxuries. If the general property tax is still to continue a fair evidence of individual ability to pay, personal property must be taken up into the assessment lists. And this, in fact, everywhere occurs. Not only the real estate, but also the growing personal estate, is now regarded. At first this personalty will consist of tangible, visible objects not easily concealed, and constituting a fair index of the citizen's prosperity. The existence of this scanty stock of personalty will, however, still be in harmony with the early economic system. It is still the landowner who owns the personal property, and it is fitting that there should still be only the general property tax. The economic system has not yet materially altered.

The next change, however, inaugurates a widely different stage. The primitive family group or manorial system decays. Slavery is gradually broken down by manumission or abolition. The commercial instinct grows stronger, and trade is no longer limited to the interchange of superfluities between adjacent households. What Aristotle decries as the gainful pursuits become common occupations. Capital develops and free laborers appear. The original undifferentiated mass of property splits up into separate parts. The landlord is no longer the property lord. Personal property, in the shape both of productive capital and of unproductive wealth, increases at a continually accelerating ratio. Finally, as in our modern industrial system, the movables outrank the immovables. Realty is completely overshadowed by personalty, in both extent and influence.

Now begins the contest between the landed and the moneyed interest, between rent and profit. The landowners in mediæval times, like the farmers in our own time, vainly attempt to expand the original property tax so as to include all these new forms of property. The capitalist and moneyed class either seek to shift the burden by devising the indirect tax of which we have spoken above, or they attempt to escape the burden entirely through evasion or through lax administration of the property tax. Where the differences in wealth become striking

and the lower classes are politically powerless, the landed proprietors and the traders combine to throw the burden on the agricultural laborers and the urban artisans, although they may still struggle between themselves as to the division of the remainder of the burden. Where aristocratic conditions prevail less strongly, as in America up to the present time, the laborer fares better, but the contest between the farmer and the city resident assumes a more acute form. The history of modern taxation is largely the history of these class antagonisms.

IV. *Changes in the Basis of Taxation*

In the meantime the test or standard of individual ability has itself undergone a change. With the growing differentiation of society, the productive powers of the various classes themselves differ. Moreover, there are now many forms of earnings which are derived not from property, but from industry. And since it is difficult to capitalize industry, it is the product of the industry which now becomes of importance. But there is a decided difference between this new system of taxes on product, and the original system which preceded the first property tax. In the original system the tax was on gross produce or on mere quantity of land. The land tax was either the tithe or some definite part of the estimated produce. Now the tax is on net produce. Allowance is made for expenses of cultivation. Two pieces of land may yield the same amount, and yet the outlay in the one case may have been considerably more than the other. To take net, instead of gross, product marks another step forward in the evolution of the idea of ability to pay. In a state of complete mobility of capital and labor, it perhaps makes no difference whether we take the market value or the net product of a piece of property; for the selling price of property tends to equal the capitalized value of the revenue derived therefrom. But in actual life, where we often find limitations to this absolute mobility, there may be a divergence between the capitalized value of the produce and the actual value of the property. Thus we find almost everywhere a movement to replace the property tax by a system of taxes on net product—on the product of land, of capital, of business, of labor, *etc.* This was the stage reached in Europe toward the end of the eighteenth and the beginning of the nineteenth century.

Relatively good as this system was, it was soon seen not to be entirely satisfactory. It failed to respond to modern eco-

nomic conditions. It looked at the produce of the source of industry, rather than at the recipient of the earnings; it was a tax on things, rather than on persons; it abstracted from the personal situation of the taxpayer; it made no allowance for indebtedness. Just as the tax on gross produce was defective because it paid no attention to expenses of cultivation, so the tax on net produce, while in itself an improvement, was nevertheless faulty because it paid no attention to what may be called the personal expenses of cultivation, *i.e.* the interest on indebtedness.

Thus it is that in recent decades the tendency has arisen to substitute personal taxes for the older real taxes, and to assess the individual rather than the thing; or, stating it in simpler language, to put revenue or income in the place of proceeds or earnings as the test of taxation. Just as a man's ability to support himself or his family is seen in his income or revenue, so, in the same way, it is recognized that the test of a man's ability to support the state is to be found in this same income or revenue. From the modern point of view, it is the duty of the citizen to support the government according to his capacity to support himself. Income or revenue may not, indeed, be an ideal test; [1] for there is no absolute test which can exactly gauge all the varying personal circumstances of each individual. But it is the best workable test that governments can secure, and it is in harmony with the test imposed on the individual by the force of social opinion in regard to his duty to his own family. For this reason modern states are everywhere changing their revenue systems, so that the taxes shall correspond, as nearly as possible, to the revenues of the citizens. But precisely because the income tax is a personal rather than an impersonal tax or a tax on things, it involves administrative difficulties and presupposes an advanced stage of social morality and political probity. Where this stage has not yet been reached, it may be better to continue the system of taxes on product which form a very rough approximation to the revenue of the taxpayer, than to attempt a system of income taxes which strive to reach the revenue more closely. Furthermore, as we shall see in a subsequent chapter, there are certain considerations which militate against the exclusive adoption of individual faculty as the all-controlling norm of taxation. But whatever may be the

[1] For some of the difficulties connected with the theory of the income tax see Seligman, *The Income Tax*, 1911, Introduction, § 4, *et seq.*

momentary demand of expediency, or the influence of countervailing considerations, the line of development is evident, and the ultimate result must necessarily harmonize with the facts of economic and social relations.

Let us test the theory of development as laid down in the above pages by a reference to the history of taxation in America. It is well known that the primitive revenues of the colonies were composed largely of voluntary payments, of subsidies or allowances from abroad, of quit-rents, and of occasional fees and fines of early justice. But it has usually been overlooked that when the voluntary offerings turned into compulsory contributions, the tax systems in the various colonies were quite different.

The New England colonies were democratic communities where almost every one owned some land, and where the distribution of property was fairly equal. We therefore find as a characteristic mark of New England, in addition to the primitive poll tax, the tax on the gross produce of land either actual or computed according to the quantity or quality of the land. This slowly grew into a real property tax, which soon expanded into what was nominally a general property tax. And this itself was supplemented by a tax on town artisans and others who subsisted on the produce not of their property, but of their exertions. To the property tax was now added the "faculty" tax.[1]

In the Southern colonies, which were aristocratic in their economic substratum, the land tax played an insignificant rôle, because the large landowners naturally objected to bearing the burdens. After the introduction of slavery it became difficult to retain even the poll tax, which when laid on slaves is practically a property tax on the slave owner. Hence we see a system of indirect taxes, mainly on exports and imports, falling with special weight on the poorer consumers.

Finally, in the middle colonies, above all in New Netherlands, the conditions were neither democratic nor aristocratic. There was no such approach to equal distribution of wealth as in New England, and no such preponderance of the landed interest as in Virginia. We find the dominance of the moneyed interest or of the trading classes, who brought with them Dutch instincts and Dutch methods. Accordingly, there was no system of poll and property taxes as in New England, and no system of in-

[1] For details as to the American "faculty" taxes, see Seligman, *The Income Tax*, 2d ed., 1914, pp. 367 *et seq.*

direct taxes on exports and imports as in Virginia. The fundamental characteristic of this system was the introduction of the excise system or indirect taxation of trade, which was borrowed from Holland, just as we find the excise system introduced from Holland into England and the other European countries during the seventeenth century. Each section, therefore, had a fiscal system more or less in harmony with its economic conditions. It was not until these conditions changed during the eighteenth century that the fiscal systems began somewhat to approach each other; and it was not until much later that we find throughout the country a general property tax based not on the produce, but on the market value, of the property.

The same divergence of economic conditions explains what is to-day the most marked distinction in the United States between the fiscal systems of the North, the South and the West. In the Southern states up to the civil war, the interests of the large landed proprietors were still dominant. Under the federal constitution, it was impossible for them to levy import or export duties. For a time, therefore, land, as the only source of wealth, had to defray the public charges. In the absence of industrial centres, there was little opportunity for taxation of personal property. As the need of increased revenues was felt, the landed interests attempted to secure this revenue from the few ordinary occupations carried on outside of the farms and estates. In other words, the license or privilege system was established, which levied a fixed charge on well-nigh every occupation. It was not until after the middle of the century that the general property tax was introduced; but even to-day the license or privilege taxes yield a large share of the public revenue.

In the Northern states, on the other hand, where the business interests were more powerful, the license or privilege system never attained such a firm foothold. But with the breakdown of the general property tax, the attempt of the general public to secure a taxation of the moneyed interests has taken the form of taxation of corporations and of capital. There are plainly visible the beginnings of a system of taxation of net product. Finally, in the Western states, where the economic conditions are as yet more primitive, there have been only sporadic attempts to alter the general property tax, which there is still to a great extent a tax on real estate. But with the gradual unification of economic conditions, which is slowly taking place throughout

the entire country, we may expect that the systems of taxation will become more nearly uniform, until the results of modern industrial and democratic development will finally appear here, as they are appearing in other parts of the world. The recent attempt to introduce a federal income tax, however defective the measure may have been, is a significant evidence of the trend. That this attempt will ultimately be followed by others, not necessarily precisely similar, but yet indicative of the same general movement, is by no means improbable.

From the above survey one fact stands out prominently. Amid the clashing of divergent interests, and the endeavor of each social class to roll off the burden of taxation on some other class, we discern the slow and laborious growth of standards of justice in taxation, and the attempt on the part of the community as a whole to realize this justice. The history of finance, in other words, shows from one point of view, at least, the evolution of the principle of faculty or ability in taxation—the principle that each individual should be held to help the state in proportion to his ability to help himself. In the earliest indirect payments there was no idea of equity, but only of force. But with the advance of civilization and social ethics, we reach the first stage of rude equality in the poll tax. Step by step the revenue system advanced to successively higher planes. Expenditure, property, product—each of these in turn was considered the test of individual capacity and obligation toward the state; until finally in modern times revenue or income has come to be regarded as the most equitable and the most practicable measure of individual and social faculty. To arrange a system of taxation a large part of which at least shall, on the whole, correspond as closely as possible to the net revenues of individuals, and which shall take into account the variations in tax-paying ability, has thus become a demand of modern civilization. But unless this system is in harmony with the external structure and the internal conditions of modern economic life, it is foredoomed to failure. If the history of taxation teaches any one lesson, it is that all social and moral advance is the result of a slow process and that while fiscal systems are continually modified by the working out of ethical ideals, these ideals themselves depend for their realization upon the economic forces which are continually transforming the face of human society.

CHAPTER II

THE GENERAL PROPERTY TAX

THERE is perhaps no single feature of our modern tax system that is commonly thought to be more thoroughly American than the general property tax. The proportional taxation of all property is held to be the result of an instinctive feeling original to and thoroughly ingrained in the minds of the American people. And yet it may be said that few institutions have evoked of late more angry protests and more earnest dissatisfaction than this very tax. The reason is plain. As long as prosperity was general and the public expenses were small, taxation was light and its burden was scarcely felt. But during the last few decades, with the complicated demands of modern civilization, public expenditures, both local and national, have increased to such an extent as to exert a sensible pressure on the population. The problems of public revenue have been pushed to the front. The expressions of discontent with various phases of the financial system have become numerous and loud. But for the most part the discussion has been superficial and the conclusions reached have been inadequate.

The opponents of the general property tax have confined themselves to a portrayal of its practical shortcomings. No one has hitherto attempted to give the deeper reasons why the property tax is unsuited to the present generation, or to discuss the subject in its wider relations to the science of finance. It is proposed in this chapter to show that the property tax is by no means original to America, but that it has gone through precisely the same evolution in many other places. It is further proposed to prove that the property tax is as destitute of theoretical justification as it is defective in its practical application. And it is proposed, finally, in subsequent chapters, to discuss the reforms of our direct taxation—some of them partly completed, some projected, and some hitherto neglected.

I. *Practical Defects*

The defects of the general property tax may be treated under five heads.[1]

[1] In a monograph by the present writer entitled *Finance Statistics of the*

1. *Lack of uniformity*, or inequality of assessment. The property tax with us is an apportioned, not a percentage tax. According to the latter method, the tax would be levied on the individual by means of a fixed percentage of all property. According to the actual method, the total amount to be raised by the state is first ascertained and is then apportioned to the various subdivisions according to the appraised valuation in each. The final rate of taxation throughout a state is obtained by adding the local tax to the state tax. The rate of taxation ought therefore to vary only with the local needs, and would indeed so vary if property were everywhere assessed uniformly. As an actual fact, however, this is far from being the case. In most of the commonwealths the tax laws provide for the assessment of property at its "fair cash value." And in all the states it is expected that the valuation shall everywhere be made at a uniform rate. Yet it is a notorious fact that in scarcely any two contiguous counties is the property—even the real estate—appraised in the same manner or at the same rate. In regard to the manner, it frequently happens that corporation property, *e.g.* the roadbed of a railway, is assessed in one county at an immense sum per mile and is treated in the adjacent county like a piece of grazing land.[1] In regard to the rate, the assessors follow the practice sanctioned by local usage, or decide by mere caprice. The official reports abound with com-

American Commonwealths (Publications of the American Statistical Association, Dec. 1889) may be found a large number of citations from the commonwealth financial reports for the preceding year. The reader is referred to that publication for the verification of statements for which no special authority is adduced in these pages. See especially pp. 401–417. Many facts and figures may also be found in Ely, *Taxation in American States and Cities*, 1887. See also, for some striking statistics, T. G. Shearman, *Taxation of Personal Property, impracticable, unequal and unjust*, 1895.

For the two decades that have elapsed since this chapter was originally written, facts in abundance testifying to the defects of the general property tax will be found in most of the official state reports on taxation. See chap. xx, below. *Cf* also the valuable articles and addresses in the (thirteen) *Proceedings of the Conferences on Taxation under the Auspices of The National Tax Association*, 1907–1920 (Columbus, 1908. New York, 1921). See especially the "Report of the Committee on Causes of Failure of General Property Tax" in the *Fourth Conference*, Columbus, 1911, pp. 299–310. At the second conference the name was changed to International Tax Association, but at the fifth conference the original name was resumed.

[1] In New York, for example, two adjoining counties made a difference of $24,000 per mile in assessing the same railroad. Other counties varied $20,000 per mile. *Report of the State Assessors*, 1879, p. 19.

plaints or open confessions that property is assessed all the way from par to one twenty-fifth of the actual value. In one county the property is listed at its full worth; in the next county the assessment does not exceed a tithe of its value.[1] That this is a glaring infraction of the fundamental rule of equality in taxation is apparent. As between counties it leads to undervaluations which give an entirely fallacious view of the public resources; as between individuals it results in gross injustice. A tax rate of a given amount on one may be double, quintuple, or decuple the nominally equivalent tax on another. The first constitutional injunction—that of uniformity of taxation—is flagrantly violated. Assessors are compelled openly to disregard their oaths, or to incur certain defeat at the next election.[2] There is no pretence of complying with the law.

An escape from these evils has been sought in the creation of state boards of equalization. A number of commonwealths[3] attempted to correct the undervaluation of the county officials by giving a state board power to alter the valuations (or in some cases, as Nebraska, the rates) in the hope of securing uniformity. In a few states, like New York, Ohio, Tennessee, Utah and Wyoming, the power extended only to the equalization of real estate assessments. In some cases, the board might change the valuation of classes of property separately, and in still fewer instances, like Connecticut, Indiana, Maine, New Hampshire and South Carolina, the assessment of minor districts. But in most cases its function was confined to the equalization of county assessments, while county boards dealt with the assessments of local districts, and ordinarily also had power of review over the assessments of individuals.[1] In several cases,

[1] *Biennial Report of the Auditor*, 1886, p. 4. In Illinois the range was from 100 to 5%. *Report of the Revenue Commission of Illinois*, 1886, p. ii.

[2] *Report of the Assessors of New York*, 1886, p. 20. In one case an assessor asserted that it would be necessary to swear the merchant. The latter answered: "If you swear me, I'll vote against you next time." *West Virginia Tax Commission, Preliminary Report*, 1884, p. 13.

[3] State boards of equalization are found almost from the beginning in the New England states, spreading gradually to the Western and, after the Civil War, to the Southern states. By 1900 they were found in over twenty States, by 1912 in thirty two-states, and by 1921, if we include tax commissions with power of equalization, in over forty states. A sketch of the history will be found in H. L. Lutz, *The State Tax Commission*, 1918, pp. 19–33. *Cf.* S. T. Howe, "The Central Control of the Valuation of Taxable Subjects" in *Readjustments in Taxation* published by the *American Academy of Political and Social Science*, 1915, pp. 112–130.

county assessments, while county boards deal with the assessments of local districts, and ordinarily also have power of review over the assessments of individuals.[1] In several cases, while these may raise, they may not reduce, the aggregate as returned by the local assessors; in other cases their power extends only to real estate; in still other cases they may raise or lower the assessment of separate classes of property as well.

The efforts of both state and county boards, however, have been very imperfectly successful. The composition of the boards is such as to render any comprehensive scrutiny of the county returns almost impossible. Even were the boards to be ideally constituted, the local jealousies and bickerings would still continue to prevent any just distribution of the burdens.[2] The officials themselves confess that such distribution cannot be secured under the present system.[3] Boards of equalization are thus at best mere makeshifts,—clumsy attempts to accomplish the impossible. As it has been drastically put: "A people cannot prosper whose officers either work or tell lies. There is not an assessment roll now made out in this state that does not both tell and work lies."[4] As long as this is true, boards of equalization are of little avail.

2. *Lack of universality*, or failure to reach personal property. This defect although the most flagrant, perhaps requires the

[1] County boards of equalization exist in most of the states, even when state boards are unknown. Thus in Delaware, Florida, Maryland, Mississippi; Nevada and Texas there were in 1912 county boards, but no state boards. On the other hand, in Connecticut, Maine, New Hampshire and West Virginia there were state boards but no county boards. Finally in Georgia, Louisiana, Massachusetts, Vermont and Virginia, there were neither state nor county boards. For details see the census report *Taxation and Revenue Systems of State and Local Governments*. The subsequent decennial report appeared in a more convenient form as *Digest of State Laws relating to Taxation and Revenue*. Washington, 1924.

[2] "The strife between counties to reduce assessments has not ceased and in all probability will not, as long as assessors are elected, or selfishness be a passion in the human breast." *Report of the California State Board of Equalization*, 1885 and 1886, p. 4.

[3] "No board of officials, however diligent or however conversant they may be with the subject, can make an equalization which to themselves will be absolutely satisfactory." *Annual Report of State Assessors of New York*, 1887, p. ii. From ocean to ocean the same complaint is found.

[4] M. I. Townsend, in *Proceedings and Debates of the Constitutional Convention of New York*, 1867–68, iii., p. 1945. *Cf.* the first *Report of the (New York) Commissioners to revise the Laws for the Assessment and Collection of Taxes*, 1871, p. 33.

least comment; for it is so patent that it has become a mere byword throughout the land. The escape of personal property is noted almost from the beginning of the existence of the property tax in the American colonies. Thus in Massachusetts Bay as early as 1651 we find an interesting account of the difficulty experienced in ascertaining certain personalty, followed by a resolution to the effect that

> "To the end that all publicke charges may be aequally borne, and that some may not be eased and others burdened and it being found by experience that visible estates in land, corn, cattle are, according to order, wholly and fully taxed, but the estates of marchants, in the hands of neibours, straungers, or their factors, are not so obvious to view, but, uppon search, little of theire estates doe appeare, beinge of great valew, so that the law doth not reach them by that rule of taxing visible estates,—it is therefore ordered. . . . that all marchants, shop-keep.s and factors shall be assessed by the rule of common estemation. according to the will and doome of the assessors. . . . having regard to theire stocke and estate, be it psented to view or not.[1]"

This was evidently not of much use, for we soon after find an admonition to the officials to see "that so many estates, though more obscure and difficult to find out, may bear their due and just pportion with such estates as are more obvious and cannot be hid."[2]

What was true in a certain measure at this early date has become still more true of recent years. Personal property nowhere bears its just proportion of the burdens; and it is precisely in those localities where its extent and importance are the greatest that its assessment is the least. The taxation of personal property is in inverse ratio to its quantity; the more it increases, the less it pays. The reason is plain. So far as it is intangible, personal property escapes the scrutiny of the most vigilant assessor; so far as it is tangible, it is purposely exempted in its chief form, as stock in trade, in our commercial centres. In the mad race for wealth it is considered dangerous for the local assessors in large cities to list the merchant's capital, with the possible result of driving it away to localities more favored by their financial officers. It is scarcely necessary to give figures to substantiate these statements; but

[1] *Records of the Governor and Company of Massachusetts in New England*, edited by N. B. Shurtleff, Boston, 1853, vol. iii., p. 221.

[2] *Ibid.*, vol. iii., p. 426.

a few facts, taken from the official documents, national, state and municipal, may be of interest.

The tenth census of the United States asserts that from 1860 to 1880 the assessed valuation of real estate increased from 6,973 millions of dollars to 13,036 millions, while that of personal property decreased from 5,111 to 3,866 millions. In 1890 the assessed valuation of real estate had grown to 18,956, while that of personal property was 6,516 millions. Scarcely more than three decades earlier in California personal property was assessed in 1872 at 220 millions of dollars, in 1880 at 174 millions, and in 1887 at 164 millions,—a net decrease in fifteen years of 56 millions. Real estate increased during the same period from 417 to 791 millions. Personal property paid 17.31 per cent, real estate 82.69 per cent of the taxes. By 1893, although the assessed value of real estate was 1,000 millions, that of personalty was only 173 millions. In Illinois in 1882 personal property paid 22.01 per cent of the taxes, in 1894 only 17.26 per cent. In Cook County (including Chicago), personal property paid only 14 per cent; in Kankakee County, only 11 per cent. In Iowa, while the real estate valuation in 1893 increased over that of the preceding year by 32 million dollars, the assessed valuation of personal property actually decreased. In New York the figures are as follows:

	Real Estate	Personal Property
1843	$ 476,999,000	$118,602,000
1859	1,097,564,000	307,349,000
1871	1,599,930,000	452,607,000
1888	3,122,588,000	346,611,000
1893	3,626,645,000	411,413,000
1911	9,639,001,868	482,499,193[1]

The proportion paid by personal property has decreased steadily almost every year, until according to the figures of 1910 it pays but five per cent of the state taxation, as against ninety-five falling on real estate. In forty years the valuation of real estate has increased 8 billions; that of personalty has increased only 30 millions. In the District of Columbia the valuation was in 1878: realty 83 millions, personalty 17 millions; in 1894 realty had increased to 160 millions, personalty had decreased to 11 millions. In New Jersey, in 1887, in one

[1] A part of this prodigious difference between real and personal property is due to the placing of considerable personalty like bank stock and mortgages in special classes.

township the real estate was assessed at $272,232, the personal property at $591; in another the figures were $2,274,900 and $17,150 respectively. Perhaps the most remarkable figures are found in the large cities. In Cincinnati the valuation in 1866 was: realty, $66,454,602; personalty, $67,218,101. In 1892 the realty had increased to $144,208,810; the personalty had decreased to $44,735,670. In Monroe County, New York, in which the city of Rochester is situated, the realty was assessed in 1892 at $132,202,478; the personalty at $8,408,803. Finally, in the city of Brooklyn in 1893 real estate was assessed at $486,497,186, while personalty was valued at $19,123,170. Personal property, in other words, paid a little more than *three per cent* of the whole tax on property. In 1895 the proportion fell still lower,—to *one and twenty-three hundredths per cent.*

These striking figures become ridiculous when it is remembered that in our modern civilization the value of personal property far exceeds that of real estate, as understood by the taxing power. It is true that the legal distinction between real and personal property fluctuates in the various commonwealths; but in the eyes of the assessors real estate generally includes only land and the fixtures thereto, all the other forms of wealth being regarded as personal property. In Massachusetts and a few other states it is indeed provided that mortgages of real estate shall be regarded and taxed as interests in real estate. But even if mortgages were counted as real estate, and even if (as is nowhere done) other certificates of ownership in realty were also counted as real estate, it would still remain true that personal property constitutes the greater part of the national wealth. For personal property does not denote merely movable objects. It includes money, public obligations and the vast mass of intangible property represented by securities of corporations, of which only a small portion are certificates of ownership in realty. Above all, personal property includes the entire and ever-increasing annual products of agriculture and industry—the gigantic mass of modern wealth devoted mainly to consumption, but existing as the stock in trade of individuals. Even in our western commonwealths, where the communities are still mainly agricultural, it is an acknowledged fact that the personalty exceeds the realty. The auditor of Washington tells us that, if a true valuation could be reached, it is "clear and incontestable that the wealth of the territory in personal property, for the purposes

of taxation, would largely predominate over that of real estate." [1] And if this is true of the far West, how much greater must be the relative proportion of personalty in the busy marts of the East.[2] Yet the more differentiated the industry and the more predominant the personalty, the less does the latter contribute; until in the foremost state of the Union realty pays more than nine-tenths and personalty less than one-tenth; while in its second largest city realty in 1893 paid ninety-nine hundredths and personalty only one hundredth of the tax. The later figures are even more striking.

The taxation of personal property, therefore, is in inverse ratio to its quantity. The more it increases, the less it pays. The general property tax thus sins against the principle of universality of taxation even more than against the principle of uniformity. In the middle ages whole classes were exempt by express provision of the law; in our time and country whole classes are exempt by the inevitable working of the law. It is the law which is equally at fault in both cases.

3. *Incentive to dishonesty.* One of the worst features of the general property tax is that any attempt to enforce the taxation of personalty by more rigid methods results in evasion and deception. The property tax necessarily leads to dishonesty, and this for two reasons. In the first place, under our system, whole classes of personalty are exempt from state taxation. The most familiar examples are imported merchandise in the original package; United States bonds, notes, checks and certificates; property *in transitu;* goods produced in another state sent on commission; deposits in savings banks, *etc.* The temptation for the taxpayer to convert his property temporarily into these classes is generally irresistible. Not only does the law hold out to individuals inducements to practise fraud, but it sustains them in its commission.[3] Secondly, wherever any pre-

[1] *Report of the Territorial Auditor to the Legislative Assembly*, 1887, p. 94. *Cf. Biennial Report of the Auditor of Iowa*, 1881, p. 8, and that of the *Comptroller of Idaho*, 1887–88, p. 74, to the same effect.

[2] *Cf. New York State Assessors' Report*, 1880, and *Comptroller's Report*, 1889, p. 33: "I am sure that the actual value of the personal property legally liable to taxation exceeds that of the real estate."

[3] In People *ex rel.* Ryan, 88 N. Y. 142, the Court of Appeals held that the assessors were bound by a transaction which the court itself declared to be "a device to escape taxation." In 1892, however, a law was passed in New York requiring applicants for reduction of assessment to make oath that they had not incurred debts for the purpose of avoiding taxation.

tence is made of enforcing the tax on personalty, and especially where the taxpayers are required to fill out under oath detailed blanks covering every item of their property, the inducements to perjury are increased so greatly as to make its practice universal. The honest taxpayer would willingly bear his fair share of the burden; but even he cannot concede his obligation to pay other men's taxes. When an effort is made to introduce still more drastic methods by the employment of so-called "tax-inquisitors" or "tax-ferrets," as until formerly in Ohio and Iowa, and recently in Indiana, Kentucky and Oklahoma, the situation becomes still worse. The only result of more rigid execution of the law is a more systematic and widespread system of deception. Official documents tells us that "instead of being a tax upon personal property, it has in effect become a tax upon ignorance and honesty. That is to say, its imposition is restricted to those who are not informed of the means of evasion, or, knowing the means, are restricted by a nice sense of honor from resorting to them." [1] The tax commission of New Hampshire declares that "the mere failure to enforce the tax is of no importance, in itself considered, in comparison with the mischief wrought in the corrupting and demoralizing influences of such legislation." [2] The Illinois commission asserts that the system is "debauching to the conscience and subversive of the public morals—a school for perjury, promoted by law." [3] The Connecticut commission maintains that the resulting "demoralization of the public conscience is an evil of the greatest magnitude." [4] A later New York report states that "it puts a premium on perjury and a penalty on integrity." [5] The Ohio commission tells us that "it results in debauching the moral sense and is a school of perjury, imposing unjust burdens on the man who is scrupulously honest." [6] The Cleveland commission of 1895 says that "the existing system is productive of the gravest injustice; under its sanction, grievous wrongs are inflicted upon those least able to bear them; these laws are made the cover and excuse for the grossest oppression and

[1] *Report of the Commissioners of Taxes and Assessments in the City of New York*, 1872, p. 9.

[2] *Report to the Legislature*. By *Hon. George Y. Sawyer*, 1876, p. 16.

[3] *Report of the Revenue Commission*, 1886, p. 8.

[4] *Report of the Special Commission on Taxation*, 1887, p. 27. *Cf.* the *New Jersey Tax Commission Report*, 1880, p. 11.

[5] *Report of Counsel to Revise the Tax Laws of New York*, 1893, p. 12.

[6] *Report of the Tax Commission of Ohio*, 1893, p. 22.

injustice; above all and beyond all, they produce in the community a widespread demoralization; they induce perjury; they invite concealment. The present system is a school of evasion and dishonesty. The attempt to enforce these laws is utterly idle."[1] The West Virginia commission tells us that "the payment of the tax on personalty is almost as voluntary and is considered pretty much in the same light as donations to the neighborhood church or Sunday-school."[2] The New Jersey commission tells us that "it is now literally true that the only ones who pay honest taxes on personal property are the estates of decedents, widows and orphans, idiots and lunatics."[3] Every annual report of the state comptrollers and assessors complains bitterly that the assessment of personalty is nothing but an incentive to perjury.[4]

4. *Regressivity.* Taxes are progressive when their increase is more than proportional to the increase of the property or income taxed, *i.e.* when the rate itself increases with the increase of the property. Taxes are regressive when the rate increases as the property or income decreases. The general property tax in its practical effects is often regressive, since the tax on personalty is levied virtually only on those who already stand on the assessor's book as liable to the tax on realty. Those who own no real estate are in most cases not taxed at all; those who possess realty bear the taxes for both. The weight of taxation really rests on the farmer, because in the rural districts the assessors add the personalty, which is generally visible and tangible, to the realty, and impose the tax on both. We hear a great deal about the decline of farming land. But one of its chief causes has been singularly overlooked. It is the overburdening of the agriculturist by the general property tax. What is practically a real property tax in the remainder of the state becomes a general property tax in the rural regions. The farmer bears not only his share, but also that of the other classes of society. Thus official documents tell us that "the class of property that escapes taxation most is the class of property that

[1] *Report of the Special Committee on Taxation of the Cleveland Chamber of Commerce*, 1895, p. 10.

[2] *Preliminary Report of the Tax Commission*, 1884, p. 10.

[3] *Report of the Commission to investigate the Subject of Taxation in the State of New Jersey.* Trenton, 1897, p. 75.

[4] *Cf. Report of California Board of Equalization*, 1885–86, p. 6. For similar quotations from the reports of later tax commissions, see chaps. xix, xx of the earlier editions of this work.

pays the largest dividends." [1] And in general it may be said, with our state auditors, that "the property of the small owner, as a rule, is valued by a far higher standard than that of his wealthy neighbor." [2] Or, as it is put by others: "In every portion of the state we find the most unproductive property, and that of the lowest real value, assessed at the highest ratio. The rule holds good that those who have to battle hardest with life for subsistence, are compelled to pay the most onerous taxes on the real value of their property." [3]

It is no wonder that in their desperation the small farmers should cry out for the equal enforcement of the laws taxing personalty; it is no wonder that they should attempt to stem the current in ignorance of the impossibility of the task. They have forgotten Walpole's saying, that it is safer to tax real than personal estate, because "landed gentlemen are like the flocks upon their plains, who suffer themselves to be shorn without resistance; whereas the trading part of the nation resemble the boar, who will not suffer a bristle to be pluckt from his back without making the whole parish to echo with his complaints." [4]

5. *Double taxation.* Double taxation, as we shall see later on, is of various kinds. But there is one form which is particularly applicable to the property tax, namely that of debt exemption. This is perhaps the greatest weakness of the general property tax, and the one which has given rise to the most interminable discussion.

On the one hand it is maintained that an offset should be made for all indebtedness, whether mortgage debts on real property or general liabilities on personalty. Individuals should be taxed on what they own, not on what they owe. To tax both borrower and lender is double taxation. This is the view of the Connecticut commission, [5] and the practice of most of the states accords with it. On the other hand, the majority of American investigators assert that deduction for indebtedness results practically in such injustice and deception as to be utterly unendurable. They therefore demand that there shall be no offset of

[1] *Biennial Report of the Auditor of Iowa*, 1880–81, p. 6.

[2] *Biennial Report of the Auditor of Kentucky*, 1887, p. iv.

[3] *Report of the State Assessors of New York*, 1873, p. 9. *Cf. West Virginia Tax Commission, Preliminary Report*, 1884, p. 8; *Report of the Comptroller of Tennessee*, 1888, p. 16.

[4] *Cf.* Sinclair, *History of the Public Revenue*, vol. iii., appendix, p. 79.

[5] *Report of the Commission of* 1887, p. 26.

debts against property. This is the view of the Massachusetts and New Jersey commissions,[1] and the practice in some states like Pennsylvania, Georgia, Kentucky, Louisiana, Maryland and Missouri.

Both these views are correct. To tax both lender and borrower for the same property is plainly double taxation, and therefore unjust. The fallacy of the contrary opinion consists in looking at the property rather than at the owner. What the state desires to reach is primarily the individual. It taxes his property simply because it considers this a test of his ability to pay. But his ability is manifestly reduced *pro tanto* by his debts. His true taxable property therefore consists in his surplus above indebtedness. Otherwise one would be taxed for what he has, and another for what he has not. As it has been well put, what we want to tax is ability, not liability. This is the view accepted by all European authorities.[2] The only American scientist who holds to the contrary opinion, Amasa Walker, does so in a half-hearted way; for he bases his view on arbitrary data, confesses that much hardship will ensue, and finally concludes that the income-tax principle is the only just one.[3] To tax both property and credits, both lender and borrower, is plainly incorrect in principle and inequitable in practice.

On the other hand, it is equally true that deduction for debts is thoroughly pernicious in its operation. It is the universal testimony that no portion of the tax laws offers more temptations to fraud and perjury than this system of offsets. The creation of fictitious debts is a paying investment. In the states where such deductions are permitted, attempts to obtain immunity from taxation in this way are widespread and generally successful. And they are most successful in the case of property which already bears less than its share of the burdens. The great majority of officials cry out against debt-exemption as an utter abomination.[4]

Both methods are thus unendurable. Debt-exemption and no debt-exemption are equally bad. The states shift from one

[1] *Massachusetts Commission*, 1875, pp. 95–98; *New Jersey Commission*, 1880, p. 20; *Commission of* 1891, *Preliminary Report*, p. 10.

[2] Roscher, *Finanzwissenschaft*, p. 336; Wagner, *Finanzwissenschaft*, ii., p. 432.

[3] A. Walker, *Science of Wealth* (7th edition), 339.

[4] *Report of the Commissioners of Assessment and Taxation in Oregon*, 1886, p. 9.

policy to the other in equal despair. We are therefore forced to the conclusion that the whole system is unsound. The fault lies not in the exemption, but in the taxation, of property. The general property tax under either of these two methods produces crying injustice. As there is no third method possible, the inference is that the injustice is of the essence of the general property tax. The New York commission, indeed, came to the conclusion that mortgage debts should be deducted from realty, but that there should be no offset for debt in the assessment of personalty.[1] This would be a legal discrimination wholly subversive of the first principles of justice. As a matter of fact, just the contrary principle prevails at present in New York and Connecticut; debts are there deductible only from personalty. There is no logical escape from one of the two methods, debt-taxation or debt-exemption; and under either plan the general property tax stands convicted by the test of experience.

Under a system, indeed, where there is no general property tax, but simply a tax on real estate, the question of taxing mortgages assumes a different aspect and must be decided independently. As that problem is discussed elsewhere in this volume,[2] it may be omitted here. But as soon as we have the general property tax and exempt mortgage debts on real estate, the exemption must consistently be accorded to all debts. And we are then immediately confronted by the dilemma just discussed.

If we sum up all these inherent defects, it will be no exaggeration to say that the general property tax in the United States is a dismal failure. No language can be stronger than that found in the reports of the officials charged with the duty of assessing and collecting the tax. Whole pages might be filled with such testimony from the various states. Only the following extracts from the New York reports are given, as samples:

"A more unequal, unjust and partial system for taxation could not well be devised.[3]

[1] *First Report,* 1871, pp. 60–69, 71–79. *Cf.* the sharp criticism in the *Massachusetts Tax Commissioners' Report,* 1875, p. 96.

[2] *Infra,* chap. iv.

[3] *First Annual Report of the State Assessors,* 1860, p. 12.

The defects of our system are too glaring and operate too oppressively to be longer tolerated.[1]

The burdens are so heavy and the inequalities so gross, as almost to paralyze and dishearten the people.[2]

The absolute inefficiency of the old rickety statutes passed in a bygone generation [is patent to all].[3]

The hope of obtaining satisfactory results from the present broken, shattered, leaky laws is vain.[4]

The system is a farce, sham, humbug.[5]

The present result is a travesty upon our taxing system, which aims to be equal and just.[6]

[The general property tax is] a reproach to the state, an outrage upon the people, a disgrace to the civilization of the nineteenth century, and worthy only of an age of mental and moral darkness and degradation, when the 'only equal rights were those of the equal robber.'"[7]

After such self-criticism nothing more need be said. In comparison with this, the view of the European scientists is moderate, that "a cruder instrumentality of taxation has rarely been devised."[8] And yet, notwithstanding all this criticism, our methods limp along almost unchanged.

II. *History of the General Property Tax in Antiquity*

In the previous chapter we have learned how direct taxation begins, and have seen that the primitive form is the land tax or tax on real estate. We also noticed the process by which the original mass of property is gradually broken up, and personal property slowly assumes a greater importance in the wealth of the community. Let us study a little more in detail the subsequent history.

The monarch, or public opinion as reflected in the government, seeks to conform the practice of taxation to this change in economic facts. The property tax continues, but the assessor tries to make the tax equable by including not only the realty, but also all these new forms of personalty, whether corporeal or incorporeal. The original land tax is supplemented

[1] *Comptroller's Report*, 1859.
[2] *Assessors' Report*, 1873, p. 3.
[3] *Assessors' Report*, 1877, p. 5.
[4] *Report of Commissioners of Taxes and Assessments*, 1876, p. 52.
[5] *Assessors' Report*, 1879, p. 23.
[6] *Comptroller's Report*, 1889, p. 34.
[7] *Assessors' Report*, 1879, p. 7.
[8] Leroy-Beaulieu, *Science des Finances* (5^{me}éd.), iii., p. 498: "Rarement, dans la fiscalité moderne, on a inventé d'instrument plus grossier."

by other taxes, or expanded into a general property tax. The attempt is intelligible and even laudable; for it is simply the manifestation of the ideas of equality and universality of taxation. Personal property must not escape; *ergo*, it must be included in the designation of general property and taxed equally with the real property.

The attempt is laudable, but it is futile. Personalty will evade the most inquisitorial assessor. Wherever tried, the general property tax again resolves itself into the real property tax. History shows us that this has always been the case. The more complex the industrial development, the more inevitably does this process take place and the more surely does the general property tax virtually revert to its primitive form of real property tax. Not alone history, but theory, shows us that this must be so. For the general property tax, as we have seen, originated with and is calculated for an economic system where the only property is the collective, indivisible property, where the landowner and capitalist are one. There is one kind of property, and therefore one kind of property tax. But as soon as property is split up into different parts, as soon as there are various kinds of property, just so soon does the single property tax become antiquated and useless. It is not only useless, but it is now absolutely iniquitous. For the attempt to include under one head the gains flowing from widely different pursuits—pursuits whose number and divergence are limited only by the well-nigh boundless variety of individual capacity—, this attempt to reduce the multiform to the uniform can end only in the virtual exemption of the new forms and a consequent overburdening of the old. What has been conceived in the spirit of justice develops into an embodiment of injustice. What has been in its origin an attempt to attain equality results in gross inequality.

Because of the evident impracticability of the general property tax, governments now begin to fit their theories of taxation to the economic facts. They abandon the attempt to make the new facts conform to the old theories. As various forms of personalty gradually set themselves free from taxation, the state reasserts the principle of equality. But it now recognizes the existing facts and abandons the fiction of the general collective property. As property splits up into its various elements, new taxes are laid, one by one, not on the property but on the separate sources of this new wealth. The old land

tax may be retained, but other taxes are imposed in various forms. Taxes on vocations, on professions, on trade, on commerce, on profits, on interest, on wages and salaries, follow in quick succession, until finally the theories and practice of taxation are in harmony with actual conditions. One by one these various sources of wealth drop off from the antiquated general property tax only to receive a new life in these fresh forms. The feeling of equity in the public consciousness cannot be put down. What escapes under one form it attempts to reach under another. Fiscal theory cannot long lag behind the facts of industrial life.

Let us test the truth of these statements by an appeal to history. Let us trace, in other words, the actual development of the general property tax.[1]

In antiquity direct taxation was treated as an extraordinary source of revenue. The Athenian direct tax (εἰσφορά) was originally a land tax levied on gross produce.[2] By the time of Nausinicus (B.C. 378) it had become a general property tax, imposed not alone on land and houses, but also on slaves, cattle, furniture, and money. The claim that it had changed by this time into a progressive income tax is unfounded.[3] The general property tax existed in many other Greek cities,[4] but so far as we can learn from the scanty sources, intangible personalty gradually slipped out of the assessment list.[5]

[1] The only general attempt thus far made to discuss this subject is that of Parieu, *Histoire des impôts généraux sur la propriété et le revenu* (1856). While interesting, it is inexact, inadequate, unclear and antiquated.

[2] Boeckh, *Public Economy of the Athenians*, book iv, chap. 5. J. Beloch, "Des Volksvermögen in Attika," in *Hermes*, vol. 20 (1885), pp. 245–6, maintains that it was a tax on produce, and most probably on gross produce. It was paid in kind until 428–7. For details see Seligman, *Progressive Taxation*, 2d ed. (1908), pp. 11–12.

[3] This is claimed by Rodbertus, in Hildebrand's *Jahrbücher*, viii., p. 453 *et seq.* For the other view see the complicated interpretation of Boeckh (p. 669 of the American edition). Beloch contends that it was still a property tax at this time, and that the taxpayers were put into associations or groups (συμμορίαι) for the purpose of a more adequate assessment of personal property. See the article quoted in the last note but one, and also "Das attische Timema," in *Hermes*, vol. 22 (1887), p. 371. Beloch's views are accepted by Ed. Meyer, *Geschichte des Altertums*, vol. ii. (1893), p. 408, note, and *Kleine Schriften zur Geschichtstheorie und zur wirthschaftlichen und politischen Geschichte des Altertums* (1910), p. 180. *Cf.* P. Guiraud, *La propriété foncière en Grèce jusqu'à la conquête romaine* (1893), livre III, ch. viii, pp. 518–546; and Francotte, *Les finances des cités grecques* (1909), p. 26.

[4] Guiraud, *op. cit.*, p. 540.

[5] *Ibidem*, p. 544.

In Rome the direct tax (*tributum civium*), which was sometimes even treated as a forced loan to be repaid out of the proceeds of conquest, was levied only to meet extraordinary expenses for which the proceeds of domains (the *vectigalia*) did not suffice. As Rome was at first an agricultural community, the real "quiritarian" property alone recognized by law consisted solely of land and the capital affixed to land, like houses, slaves and cattle. These were the *res mancipi*.[1] But the property tax was assessed only on the land, on the assumption that every acre of land would require a definite quantity of this productive capital.[2] The early Roman property tax was therefore in effect a tax on realty, analogous to the early εἰσφορά.[3] With the development of trade and industry in the later days of the republic, the character of property underwent a change. The amount of personalty increased. If the *tributum* was to remain a general property tax, it would be necessary to assess also these new forms of property. And, in truth, the attempt was made. Not only farming implements, but ships, carriages, money, garments, ornaments, *etc.*, were listed.[4] But it must be remembered that the only personalty assessed still consisted of visible, tangible objects, although the censors had practically unlimited power to take up any property into the tax-list (*census*). There is no evidence to prove that trading capital proper was at all taxed.[5] And it is useless to speculate what might have been the result during the last period of the republic; for further progress in this direction was checked by the fact that, with one isolated exception, the republic levied no direct property tax at all on the Roman citizens after 167 B.C. Whether the *tributum civium* was again employed during

[1] "Mancipi res sunt praedia in Italico solo, tam rustica, qualis est fundus, quam urbana, qualis domus; item jura praediorum rusticorum, velut via, iter, actus, aquaeductus; item servi et quadrupedes, quae dorso collove domantur, velut boves, muli, equi, asini. Ceterae res nec mancipi sunt." Ulpian, 19, 1. *Cf.* Gaius, i., p. 120; ii., pp. 15–17.

[2] Marquardt, *Römische Staatsverwaltung* (2d edition), ii., p. 166.

[3] Except that it was not a graduated tax, and was levied on the market value, not the produce.

[4] Matthias, *Römische Grundsteuer und Vectigalrecht*, 1882, p. 6. The leading ideas of Matthias are translated in Humbert, *Essai sur les finances chez les Romains*, ii., p. 328 *et seq.*

[5] The only one who maintains the contrary is Walter, *Geschichte des römischen Rechts* (3d edition), i., p. 271. But the passage of Livy to which he refers (vi., 27) does not bear out his assertion. Walter stands quite alone.

the empire is a moot question. The weightier arguments seem to be on the side of those who maintain that it was never again made use of in its old form.[1]

In the provinces the property tax was nothing but a land tax—either a tax on the value (*tributum soli*), or a tithe (*decuma*), or a ground rent (*vectigal certum* or *stipendium*). In addition to the land tax proper we find the poll tax (*tributum capitis*) which, in some of the older provinces where the remains of an enterprising commercial life still existed, probably included a tax on classes or professions or a nominal general property tax.[2]

The Roman property tax was therefore virtually a tax on land and the little productive capital affixed to land. Personalty, so far as it was assessed at all, consisted of the meagre tangible objects owned by an agricultural people. The Romans had a general property tax because, as in early Greece, there was only one kind of property—the collective property owned by slave-holding landed proprietors.

Under the empire industrial society began to differentiate. Caligula (A.D. 37–41) took advantage of this to levy taxes on special classes, above all on carriers, prostitutes and pimps.[3] Trading capital, everywhere the first element to separate itself from the collective mass of property, was reached for the first time by Vespasian (69–79) in the curious tax on the private owners of city urinals and closets.[4] Finally, shortly before Caracalla (211–217) we find a general tax on commercial capital, known henceforth as *aurum negotiatorium*. But what a singular

[1] Rodbertus, Hildebrand's *Jahrbücher*, iv., pp. 408–427, and Hewegisch, *Römische Finanzen*, p. 1346, maintain its existence. But Savigny, *Vermischte Schriften*, ii., pp. 151, 185; Huschke, *Ueber den Census zur Zeit Christi*, pp. 70, 190; Mommsen, *Römische Geschichte*, ii., p. 387; and Marquardt, *Römische Staatsverwaltung*, ii., p. 171, take the opposite view. Dureau de la Malle, in his *Économie politique des Romains*, does not touch this point. The decisive quotation is that from Tacitus, *Annales*, 13, 51, of which Rodbertus' interpretation is strained. The best argument—which has not hitherto been advanced—seems to be this: that if the *tributum civile* had continued, it would not have been necessary for Diocletian to introduce into Italy the *tributum provinciale*.

[2] Rodbertus, iv., p. 364, puts it too strongly when he says that it was only a poll tax. See Marquardt, *op. cit.*, ii., p. 195.

[3] Suetonius, *Caligula*, 40: "Ex gerulorum diurnis quaestibus pars octava, ex capturis prostituarum quantum quaeque uno concubitu mereret." *Cf.* Dio Cassius, lix., 28.

[4] Known as *foricarii*. Suetonius, *Vespasian*, 16, 23. *Cf.* for other authorties Walter, *Rechtsgeschichte*, i., p. 498.

commentary it is on the progress of civilization that the first tax on circulating capital should be on a rather degrading occupation, and the first tax on industry one on prostitutes.[1] Caracalla, we are told, conferred the privilege of Roman citizenship upon all the inhabitants of the empire in order to extend to them the now numerous direct taxes, especially the succession and manumission taxes.[2] The provincial land tax continued; but it went through the same evolution as the civic direct tax and became a general property tax.

The industrial development, however, had outrun fiscal theory. It became more and more difficult to reach personalty. More and more barbarous methods were introduced;[3] until, as Lactantius tells us in stirring language, torture was applied to the recalcitrant owner.[4] Under Diocletian the provincial land tax (known henceforth as *jugatio* or *capitatio terrena*) was introduced into Italy. But at the time of the Theodosian code and the completion of the late fiscal system, we find, not the general property tax,[5] but a vast variety of taxes, indirect and direct. Chief among the latter were those on the profits of trades, professions and artisans,[6] now consolidated into corporations through the petrifaction of industrial relations.[7] But the attempt to tax personalty by means of a general property tax was abandoned because the original mass of property had disintegrated. The primitive system was abolished, and was replaced by methods more or less analogous to those employed in modern Europe.

[1] Hildebrand's *Jahrbücher*, v., p. 315.

[2] At least this is the uncharitable construction of the act by Dio Cassius.

[3] The municipal decurions, for example, were made personally liable for the taxes levied on their municipalities. Service as decurion became compulsory and hereditary. Fugitive decurions were brought back, like fugitive serfs or military deserters.

[4] *De morte pers.* 23: Fora omnia gregibus familiarium referta; unusquisque cum liberis, cum servis aderat; tormenta ac verbera personabant; filii adversus parentes suspendebantur; fidelissimi quique servi contra dominos vexabantur, uxores adversus maritos. Si omnia defecerunt, ipse contra se torquebantur, et quum dolor vicerat, adscribebantur quae non habebantur.

[5] The poll tax (*capitatio plebeia* or *humana*) levied on the serfs (*coloni*) was practically a property tax because it was paid by the landowner.

[6] Known as *chrysargyrum*, *vectigal artium*, *pensio auraria*, and *aurum lustrale*. *Cf.* Levasseur, *Histoire des classes ouvrières en France*, i., pp. 72–78.

[7] *Cf.* Wm. Adams Brown, "State Control of Industry in the Fourth Century," *Political Science Quarterly*, ii. (1887), pp. 494–513.

III. *Early Mediæval History of the Property Tax*

During the middle ages the same development can be noticed. In the early period, after the disruption of the Roman empire, there were no taxes at all. The primitive Teutonic idea forced its way into the feudal system, and the contributions originally devoted to public purposes became the private possessions of feudal nobles and over-lords. The public tax became private property.[1]

In the early feudal system land was practically the only form of wealth, as it was the basis of the political fabric. In England the feudal payments (*hidage*, *scutage*, *carucage* and *tallage*) were assessed on the land, just as the Saxon *shipgeld* and *danegeld* were land taxes. These were at first levied on the gross produce of the land, either actual or as computed by the mere quantity of the land. With the progress of cultivation net produce rather than gross produce was made the test. Rents became the only practicable test of the value of land. But from the twelfth century onward, the growth of industry and commerce in the towns led to such an increase of personalty or movables that it became necessary to devise some new method of reaching the ability of the citizens. The only way out of the difficulty in England, as on the whole continent, was a combination of the taxes on lands and on movables through the general property tax.

The mediæval town was the birthplace of modern taxation. Every inhabitant was compelled to bear his share of the local burdens, his proportion of the scot and the lot. The scot, or tax, was almost from the very outset the general property tax combined with the subordinate poll tax, exactly as in the earliest days of the New England colonies. The town, as such, generally paid its share of the national burdens in a lump sum, the *firma burgi*. But this lump sum was always distributed among the townsmen in proportion to the property of each.[2]

[1] *Cf.* for details Clamageran, *Histoire de l'impôt en France*, i., p. 115; and Vuitry, *Études sur le régime financier de la France avant la révolution*, i., p. 420.

[2] Numerous examples may be found in Madox, *Firma Burgi*, p. 281 *et seq.* In one town, under Edward III., each man is "taxandus et assidendus juxta quantitatem bonorum et catallorum suorum ibidem." In another town the tax "debet assideri proportionaliter juxta quantitatem bonorum suorum." For London, where each freeman paid the general property tax as *partem de bonis suis* or *partem catallorum*, see the examples in *Munimenta*

On the continent it was the same. In the German towns the taxes were at first levied only on lands and houses.[1] Beginning in the twelfth century, however, other constituent elements of property, both movable and immovable, were gradually added, until before long we find the general property tax. The tempo of the development naturally varied in the different towns, but the broad lines were almost everywhere the same. Thus by the end of the thirteenth century it had become customary to add rent-charges to houses and land. As long as the rent-charges were irredeemable, they were taxed as real estate; but after they had become redeemable, they were gradually treated as personalty.[2] For in Germany as in England we find the feudal distinction between real estate and personal property (*Liegende* and *Fahrende Habe* or *Liegenschaften* and *Fahrniss*), which was almost tantamount to that between movables and immovables (*Mobilien* and *Immobilien*). The other elements of personalty were slowly added to the assessment lists. We find mentioned in the tax ordinances of the period the following classes of personal property: (1) household furniture, (2) clothing, ornaments and weapons, (3) food supplies for home consumption, (4) supplies of wine, straw and coal for the same purpose, (5) horses and cattle, (6) tools of various kinds, (7) wares and commodities, (8) money, (9) credits. At first a man's personalty was taxed only if the owner paid no tax on his real estate, but this alternative method of taxation soon disappeared. In almost all cases the various classes of personalty were assessed at fixed rates which varied for each class, but before long they were all merged into the general property tax—or, as it was called, the tax on property *in possessionibus, agris, domibus, censibus et rebus quibuscunque.*[3]

Gildhallae Londoniensis, Liber Albus, i., p. 592 *et seq.* For full details as to the method of assessment *tempore* Edward II., see *Liber Custumarum*, pp. 193 *et seq.*, 568 *et seq.*

[1] There is a rich literature of local taxation in Germany. Well-nigh every important town has had a monograph devoted to it. The general surveys are the older work of Zeumer, *Die deutschen Städtesteuern insbesondere die städtischen Reichssteuern im XII. und XIII. Jahrhundert*, Leipzig, 1878; and the more recent studies of M. E. Heidenhain, *Städtische Vermögensteuern im Mittelalter*, Leipzig, 1906; and Bruno Moll, *Zur Geschichte der Vermögensteuern*, Leipzig, 1911. Each of the last two works contains complete bibliographies of the local histories.

[2] See the full discussion in Heidenhain, *op. cit.*, pp. 62–92, esp. 68.

[3] Zeumer, *op. cit.*, pp. 86–89.

In some towns it was called simply a tax of so much *per posse* or *pro bonorum facultate*.[1] The documents often speak of a man being taxable "*na sine vermugen*," or in the Latin equivalent "*secundum propriam facultatem et bonorum suorum estimationem*"[2] or "*juxta suam possibilitatem et pro rata bonorum suorum*.[3] Many of the German towns by this time combined the general property tax with the poll tax,[4] and in the Swiss cantons the tax was even called the *Hab-, Gut-, und Kopfsteuer*.[5]

In France and in the Low Countries the conditions were the same. The tax started out as one on real estate, but soon became one on property in general, the taxpayer being assessed according to his *vaillant* (fortune), or according to his *hiretage* and *catel* (realty and personalty), the *rentes-à-vie* always being taxable as realty.[6] At St. Quentin provision was made as early as 1195 for a *collectam super omnes pecunias et hereditates burgensium;* and at Bapaume only a few years later the tax was levied *ad valentiam tenementorum et mobilium*.[7]

The only distinction between England and the continent was that in England the property tax remained for centuries the sole local tax, while in France and Germany local excises or *octrois* were soon added. But for some time at least the general property tax was the measure of the individual's capacity.

The general state taxes followed in the wake of the municipal taxes. Already in 1166 a property tax was levied throughout almost all Europe in order to aid the crusaders.[8] The English statute mentions in detail the various classes of taxable property, namely, lands and all movables including gold, silver, animals, coin, credits, the produce of vineyards, *etc.*, and provides further that those who do not own as much as a

[1] Christian Meyer, *Das Stadtbuch von Augsburg*, 1872, pp. 75, 313.

[2] Von Below, "Geschichte der direkten Staatssteuern in Jülich und Berg," in *Zeitschrift des Bergischen Geschichtsvereins*, vol. 26 (1890), p. 32.

[3] Moll, *op. cit.*, p. 37.

[4] G. von Schönberg, *Finanzverhältnisse der Stadt Basel im xiv. und xv. Jahrhundert*, Tübingen, 1879, p. 134.

[5] Blumer, *Staats- und Rechtsgeschichte der schweizerischen Democratien*, ii., p. 295 *et seq.*

[6] Espinas, *Les finances de la commune de Douai des origines au XV siècle* (1902), p. 119 *et seq.* This work is especially valuable for its wealth of detail as to the French and Flemish towns.

[7] In 1200. Espinas, *op. cit.*, p. 119, note.

[8] Sinclair, *History of the Public Revenue*, i., p. 88. For a general treatment see Gottlob, *Die päpstlichen Kreuzzugssteuern des 13ten Jahrhunderts.* Heiligenstadt, 1892.

pound should nevertheless pay a penny if they are either householders or in possession of some office.[1] A few decades later, in 1188, came the Saladin tithe, on the occasion of the third crusade, when all rents and movables (*redditus et mobilia*) were expressly made taxable.[2] In England from this time on, the grants of rents and movables (*de redditibus et mobilibus* or, as they were sometimes called, *de redditibus et catallis*) became more and more common until they finally superseded the older methods of securing revenue. The fractional parts of the property granted varied from a fortieth to a fourth; but from 1290 it became customary to tax the nobility and the clergy only two-thirds as much as the commons. In 1334 the proportion was fixed as the fifteenth and the tenth. The tax accordingly came to be known as the fifteenth and tenth (*quinzime* and *disme*). Strictly speaking, the tenth was levied in the cities, boroughs, and lands of ancient demesne, the fifteenth in the rest of the country. Practically, however, the fifteenth was a tax on rents or realty, the tenth a tax on movables or personalty.

The name applied to the English tax—fifteenths and tenths or tax on rents and movables—brings up two interesting problems. The one is, why rents or produce should have been put on a plane with movables or property; the other is, why they should have been taxed at different rates.

As to the first point, it is clear that under feudal conditions, where land was not regularly bought and sold, the simplest method of ascertaining the taxable ability of the landowner was through the rental that he received for the land, a rental that was always in a certain proportion to the produce of the land. In the case of houses in the towns, especially where the land did not belong to the large landowners, we find of course more numerous examples of transfers of real estate; and accordingly the tax on town houses was sometimes assessed according to property, instead of rental, value. This is especially true in many of the German towns.[3] In the case of rent-charges again, which in the earlier centuries were far more

[1] The ordinance is reprinted in full in Manes "Die Einkommensteuer in der englischen Finanzpolitik," in *Festgaben für Wilhelm Lexis*, 1907. It is also found in B. Moll, *Zur Geschichte der englischen und amerikanischen Vermögensteuern*, 1912, p. 7.

[2] This ordinance is printed in full in Dowell, *History of Taxation, etc.*, vol. ii (1888), appendix.

[3] As in Basel, Speyer, Mainz, Regensburg, Zürich, Bern, *etc.* *Cf.* Heidenhain, *op. cit.*, p. 54.

common on the continent than in England, it is obvious that under the prevailing conditions their value could be found only as an annuity. Accordingly the annuity or yearly rent-charge was always included in the *redditus* or returns of real estate.

Personal property on the other hand had a capital value. In fact, most of the elements of personalty yielded no money produce at all, but only what economists call a benefit or psychic income. Personalty, therefore, was taxed according to property value; realty, except in the towns, according to rental value. Thus the mediæval general property tax was really a combination of property and product tax, product being utilized when the capital value was difficult or impossible to ascertain. In England this system of distinguishing between rents and movables continued through the middle agès; on the continent and especially where feudal conditions gave way before the democratic movement, the more unified property conception gained the upper hand.

The other problem is that of the difference in rates. In England the proportion came to be, as stated, a tenth for personalty and a fifteenth for realty. On the continent the disparity was often considerably greater, the rate on personalty being frequently two or even three times as high as that on realty. Moreover, when we remember that in the case of personalty the tax was assessed on capital value, whereas in the case of realty it was assessed only on the produce of the property, the contrast becomes astonishing.

In England there is not much doubt that the difference in the rate was, in part at all events, due to the fact that the peers were politically more powerful than the commons. But in many parts of the continent we find the same practice even where the aristocrats were not in the saddle. The explanation must therefore be of a more general nature.

Some authors seek the explanation in the alleged fact that personalty, especially that part of it invested in trade and commerce, was more lucrative than real estate, and could therefore more easily endure a higher rate.[1] Apart from the fact, however, that trade capital constituted only a small part of the

[1] This is the view of Hartung, "Die Augsburger Vermögensteuer im XV. Jahrhundert" and "Die Belastung des Augsburgischen Grosskapitals," in Schmoller's *Jahrbuch, etc.*, vol. 19 (1895); and of Kolle, *Die Vermögensteuer der Reichstadt Ulm vom Jahre 1709.* Stuttgart, 1898.

taxable personalty, the alleged fact is really without foundation. Other writers advance a variation of this theory by contending that real estate, especially in the towns, was of very slight productivity. The towns, they tell us, were full of empty dwellings, the population was small, and land was not the subject of speculation as in modern times. The towns, we are told, even helped to rebuild houses that had been destroyed by fire.[1] This view, however, represents an unwarrantable generalization from a single town or a single period. A more defensible theory is that land was the basis of the entire economic life in the middle ages, and since most people even in the towns made their chief living out of the land, it was only natural that the principal means of subsistence should be treated somewhat more tenderly and that the surplus over what the individual needed for his living should be taxed at a higher rate.[2] The best explanation, however, is to be found in the fact that it was administratively more difficult to reach personal property, both because some of it was more or less hidden from the scrutiny of the assessor, and because intentional concealment and fraud were far easier.[3] As a matter of fact the assessment of chattels was not strictly enforced. This is apparent in England, at all events, from the dissatisfaction shown with the tax of 1275, when the people were assessed *ad unguem, i.e.* up to the full value of their movables.[4] In the succeeding grants the old easy practice was resumed. As the tax on lands, however, could be levied on actual rents, it was not apt to be so leniently assessed. Thus a substantial equality was probably reached.

Just as in England the tallages merged into the fifteenths and tenths, so in France the feudal charges on the land developed into the general property tax, which however still retained the old name *taille*. The ordinances of 1254–56 attempted to regulate the assessment, and provided that im-

[1] F. R. Bothe, *Die Entwickelung der direkten Besteuerung in der Reichstadt Frankfurt bis zur Revolution, 1612–1614.* Leipzig, 1906, p. 67.

[2] This theory is vigorously espoused by Heidenhain, *op. cit.*, esp. p. 53.

[3] This explanation was first advanced by the present writer in 1892, in an article in the *Political Science Quarterly*, and is found in the first edition of this work. It was independently advanced by Hartung in 1895 in the essays mentioned above, and is accepted in substance by Hartwig, *Der Lübecker Schoss bis zur Reformationszeit*, 1903, p. 47, and by Moll, *Zur Geschichte der Vermögensteuern*, 1911, p. 108.

[4] Dowell, *History of Taxation and Taxes in England* (2d edition), i., p. 68.

movables should be charged only half as much as movables.[1] France thus endeavored to attain by law what England effected by custom. During the fourteenth century the *taille* came to be the chief direct tax, and in 1439 it was made a permanent annual tax. In Germany, also, the imperial and state direct taxes, in so far as there were any, took the form of general property taxes. The *Bede*[2] or *Landbede*, the *gemeiner Pfennig*,[3] the *Landschoss*,[4] the *Landsteuer*,[5] *etc.*, all followed the example of the local property tax. In Scotland the "costage" paid to England in 1424 was a general property tax. An act of that year directed that a book be prepared, containing the names of the inhabitants with a list of all their goods, including corn and cattle, as evidences of their ability to pay.[6] By 1585 it had become customary to apportion the occasional burdens known as stents to the burghs according to their "substance and common good."[7]

In the Italian republics the commonwealth was at first supported by the general property tax. In Milan, under the name *stima e catastro de beni* it is found as early as 1208, and afterwards was levied with such severity that the assessment book was known as the *libro del dolore*.[8] In Genoa it was called *colletta*.[9] In Florence it was known as *estimo* and played an important rôle in politics.[10] And finally we find in the Netherlands from the earliest times the general property tax

[1] Clamageran, *Histoire de l'impôt en France*, i., p. 264.

[2] At first a feudal land payment; *cf.* Hüllmann, *Deutsche Finanzgeschichte des Mittelalters*, p. 133.

[3] Lang, *Historische Entwickelung der teutschen Steuerverfassungen seit der Karolinger*. Berlin, 1793, p. 182.

[4] Schmoller, "Die Epochen der preussischen Finanzpolitik," in *Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft*, i. (1877), pp. 35, 42.

[5] Hoffmann, *Geschichte der direkten Steuern in Baiern vom Ende des xiii. Jahrhunderts*, pp. 11, 17, 39.

[6] S. H. Turner, *The History of Local Taxation in Scotland*. Edinburgh, 1908, p. 151.

[7] *Ibid.*, p. 152.

[8] Carli, *Relazione del Censimento dello Stato di Milano*, in Custodi's *Scrittori Classici Italiani, parte moderna*, xiv., pp. 184, 185.

[9] "Le imposte straordinarie si possono di questa epoca [1252] comprendere in una sola, la colletta." Canale, *Storia dei Genovesi*, i., p. 318 (edition of 1844).

[10] Villani tells us that it was levied on "cio che chiascuno havea di stabile e di mobile e di guadagno." *Istorie Fiorentine fino al anno* 1348, book x., chap. 17 (vol. vi., p. 26, of Milan edition of 1803).

known as the *schot* or the tenth, *etc.*, on *bezittungen* (possessions).[1]

The general property tax thus existed throughout all Europe. It was moderately successful because well suited to the period. Although involving an inquisitorial search into every article of the scanty mediæval stock, as can readily be seen from the detailed schedules of assessments still in existence, the tax was levied chiefly on tangible, physical objects not capable of easy concealment. With the exception of countries like France, where the tax was emasculated by the system of exemptions, it resulted on the whole, during this early period of society, in a tax fairly proportional to the individual faculty. There was a general property tax because there was a very slight differentiation of property.

IV. *Later Mediæval and Modern History of the Property Tax*

Before long a change set in. In England the fifteenths and tenths were changed in 1334 from percentage to apportioned taxes. Every locality had now to raise a definite lump sum, which, it was intended, should remain the same from year to year, and which was to be apportioned in precisely the same ratio among the various counties, towns and parishes. One fifteenth and tenth therefore meant a fixed sum, and when more was needed, two or three fifteenths and tenths were imposed. The old methods of assessment, however, soon fell into disuse. Each town and county made its own arrangement and treated personal property with such leniency that the total product of the tenth and the fifteenth continually decreased. This resulted in attempts on the part of the crown to supplement the old tax by a new general property tax, called the subsidy. The early efforts met with failure, but finally, in 1514, the first general subsidy was granted, as a tax of sixpence in every pound of property. The pound rate was afterwards fixed at four shillings on lands, and two shillings eight pence on goods. But the subsidy went through precisely the same development as the fifteenth and the tenth. At first really a percentage tax, it was soon practically converted into an apportioned tax of a stated lump sum. No re-assessment of the districts took place; each locality was supposed to pay the same sum year after year. All increase in wealth was thus entirely omitted from

[1] Engels, *De Geschiedenis der Belastingen in Nederland*, pp. 60–65.

the lists. Exemption after exemption was made, and personal property was so loosely assessed that the total yield continually declined. The most arbitrary methods were employed. Only the old "subsidy-men" were taxed; allowances were made in a multitude of cases; and the assessments of personalty were so low and partial that the subsidy became a perfect farce. As Bacon said, "the Englishman is master of his own valuation." [1] Sir Robert Cecil stated in 1592 that there were not over five men in London assessed on their goods at £200; and Sir Walter Raleigh wrote in 1601 that "the poor man pays as much as the rich." [2] Although nominally a general property tax, the subsidy thus came to be levied chiefly on the land, and became an unequal land tax—so unequal that it finally disappeared in 1663.

Under the commonwealth an attempt was made to revive the general property tax, under the name of commonwealth monthly assessments, real estate being always assessed, as before, according to its "yearly value," personalty according to its value. These monthly assessments were already authorized during the Revolution. Thus in 1644 a "monethly assessment" was imposed upon the counties, cities and towns mentioned and levied upon "the true yearly values of lands, rents, annuities, offices and hereditaments and according to the true value of goods, chattels, debts and other estate reall or personall." [3] The improvement was so marked that the old subsidies were completely abandoned and replaced by the assessments. But the reform was short-lived and the assessments of personal property continually diminished. Sir William Petty, the author of the first theoretic work on taxation printed in England, discussed the defects of these monthly assessments in a picturesque passage as follows:

"There have been, in our times, ways of levying an aliquot part of mens estate, as a fifth, and twentieth of their estates, real and personal, yea of their offices, faculties and imaginery estates also, in and about which way may be so much fraud, collusion, oppression and trouble, some purposely getting themselves taxed to gain more trust: others bribing to be taxed low, and it being impossible to check or examine or

[1] And, he adds, "the least bitten in purse of any nation in Europe."

[2] *Report on Public Income and Expenditure*, 1869, ii., p. 415.

[3] *An Ordinance of the Lords and Commons assembled in Parliament for the raising and levying of the Monethly Sum of £120,000 towards the maintenance of the Scottish army, by a Monethly Assessment, etc.* Feb. 24, 1644. See esp. p. 8.

trace these collections by the print of any footsteps they leave (such as the hearths of chimneys are) that I have not patience to speak more against it: daring rather conclude without more ado, in the words of our comick to be naught, yea, exceeding naught, very abominable, and not good." [1]

A little later, however, Petty was slightly more hopeful and expressed the opinion as do some of our rural legislators to-day, that "assessments upon personal estates, if given in as elsewhere upon oath, would bring that branch which of itself is most dark to a sufficient clearness." [2]

After the Revolution the tax was levied as the so-called property tax. By its terms [3] it was assessed on the persons possessed of personal property, real estate, or public offices or positions of profit. And it was at first a percentage tax. But the yield decreased so enormously that Parliament in 1697 fixed the sum a rate should produce, *i.e.* it became an apportioned tax of stated amount. A rate of a shilling in the pound meant a tax of half a million pounds for the country as a whole, this sum being subdivided in fixed amounts to the various localities. The tax varied from three to four shillings in the pound. In the case of land the tax was assessed on the rent or yearly value. In the case of personal property the tax was assessed on the value of the property, rental value of all kinds of property being deemed to be six per cent of their capital value. In the case of "any person exercising any public office or employment of profit" where there was no capital value the tax was imposed directly on the salary.[4] Moreover, the difficulty of assessing personalty and the impossibility of reaching intangible property were now so apparent that whereas according to the intent of the law the chief revenue was to come from personal property, and only the residue from realty, in practice the tax became almost exclusively a land tax, and was first so called in 1697. The "annual land tax" of England was thus intended to be a general property tax and for a long time continued to be so legally.[5]

[1] *A Treatise on Taxes and Contributions*, by W. Petty. London, 1667, pp. 61–62.

[2] Petty, *Verbum Sapienti; or . . . the Method of raising Taxes in the most equal manner*, p. 17. (Appended to his *Political Anatomy of Ireland*, edition of 1691.)

[3] 4 William III., chap. 1.

[4] For a full explanation of the law the provisions of which are frequently misunderstood, see Seligman, *The Income Tax*, 2d ed., 1914, pp. 48–49.

[5] Adam Smith, *Wealth of Nations*, book v., chap. ii.: "By what is called

The complaints as to the escape of personal property were heard almost from the beginning. Thus in 1694 Briscoe tells us:

"And here I might take notice how the monied men are enrich'd by the ruine of the poor and industrious traders, how gentlemen (whose estates are in land) are pressed with taxes, while the monied men are in a manner tax-free; the landed man paying more tax to their Majesties out of an estate of £100 per annum or higher, than the monied men do for £10,000 in money." [1]

In the eighteenth century this had become a commonplace. A popular pamphleteer expresses himself as follows:

"This is a grievous and unequal tax. In all the remote parts of this country, the tax never was levied according to the value of their estates nor ever can be. . . Monied men are another vast body who . . . contribute little or nothing to this tax. Their stock in trade can never be known and is always assessed but a trifle. Money lent on mortgages never is taxed and stock in the funds hath the publick faith to exempt it so that it never can be taxed. With all these advantages the monied men, though they hold the greatest properties in the state, pay no proportion to the support of that government from whence they have equal protection with those who are charged at the utmost." [2]

Walpole at about the same time stated that "no man contributes the least share to this tax, but he that is possessed of a landed estate." [3] Perhaps the most severe arraignment of the justice of the tax is made, toward the middle of the century, by a well-known publicist, Decker, from whose catalogue of indictments we select the following:

"Thirdly, *It tends to corrupt the manners of the people, consequently to make them tumultuous and less governable.*

"For being to pay in proportion to what they earn, spend, or possess, the just value whereof is impossible to be known but by themselves, and to force them to a declaration, an oath is always imposed, which makes a struggle between interest and conscience; an extreme wise law, whereby an honest man is put on a worse footing than a perjured knave: he that forswears himself pays less than his due and saves his money; but he that is conscientious pays to the full; which latter sus-

the land tax, it was intended that stock should be taxed in the same proportion as land." (Thorold Rogers' edition, ii., p. 553.)

[1] *A Discourse on the Late Funds of the Million-Act, etc.*, by J. B(riscoe), 1694, p. 13.

[2] *A Letter to a Freeholder on the Late Reduction of the Land Tax to one Shilling on the Pound*, By a Member of the House of Commons, London, 1732, pp. 44, 48, 26.

[3] Dowell, *op. cit.*, vol. ii., p. 99.

pecting others to evade, is piqued at paying more than his neighbors, and wonders why a false oath should not fit as easy on him as on so many others; whereby the most solemn pledge of truth among men becomes frequently violated, is despised, disregarded, and interest rides triumphant over conscience; which latter being to men as a dike to keep out the torrent of vice, if once a thorough breach is made, a deluge of iniquity ensues, whereby all good principles are drowned; and the more vicious men grow, the readier they are to oppose authority." [1]

So unequal and so insignificant did the old general property tax (now universally known as the land tax) become that in 1798 permission was given to the landowners to buy themselves free of the tax by the payment of a capital sum. In other words, the land tax became a redeemable rent-charge. The provision taxing personal property continued to exist on the statute book until 1833, and the clause taxing public offices and positions of profit was not finally repealed until 1867. The year before its repeal it yielded the sum of £823! [2] Such was the ludicrous result of the attempt to maintain mediæval customs. The general property tax, which had started out as a land tax, reverted in name as well as in fact to its earliest form.

In Scotland the history was the same, although because of the later industrial development of the country the old system survived almost to our day.[3] The chief direct tax, known as the cess, was originally a general property tax. In the middle ages one of the functions of the Great Chamberlain was to inquire whether the public burdens were fairly "distributed to rich and poor according to their faculties." [4] A fixed proportion of the cess was allotted to each burgh and it was then paid partly out of "the common good," [5] partly out of real estate, while the remainder, if any, was assessed on the personal property and income of the taxpayers. In 1597 an order declared more precisely that the officers are to "stent" each person "according

[1] Matthew Decker, *An Essay on the Causes and Decline of the Foreign Trade*, Edinburgh, 1756, pp. 19–20.

[2] *Report of the Commissioners of Inland Revenue*, 1867.

[3] *Cf.* for a sketch of the Scotch system the *Report of the Poor Law Commissioners on Local Taxation*, 1843, and the more recent work of Stanley H. Turner, *History of Local Taxation in Scotland.* Edinburgh, 1908.

[4] "Si equaliter ponantur super divitibus et pauperibus juxta eorum facultates." Turner, *op. cit.*, p. 158.

[5] The "common good" included the public lands for grazing as well as feu duties on those parts loaned in perpetuity and river and loch fishings and also grain mills and occasionally a walk-mill and the like. Turner, *op. cit.*, p. 128.

to the avail and quantity of his rent, living, goods and gear that he has within burgh." [1] In the course of time, however, personalty slipped out of the assessment list. In Dumfries by the end of the seventeenth century the records tell us that "now by the decay of trade the cess is like to fall on the lands and houses." In Kintore the cess was "paid of the land rent."

In the counties the cess or land tax, as it was now sometimes called, was converted into a redeemable rent-charge in 1798 and 1802, as in England. In the boroughs, however, the old system continued, each borough levying the general property tax in its own way, with suitable variations. In Banff, for instance, in the nineteenth century, the tax was levied, one-half on real estate; one-quarter on trade and merchandise, according to the amount of purchases by each trader; one-eighth on the incorporated trades; and one-eighth on the other inhabitants, according to the discretion of the stent-master. In Cullen the rate was imposed on land and on trade each being rated "according to his understood ability to pay." [2] So burdensome and vexatious were the remains of the property tax felt to be that the Commission of 1835 recommended the entire abolition of the trade-stent, as it was called. It was, however, not until 1896 that the whole system of borough contribution to the cess was abolished and with it all attempts to raise any part of the tax from personal property.[3] That was the end of the state general property tax in Scotland.

In other countries the history of the property tax is identical. In France the *taille* was of two kinds; the *taille réelle,* which was levied only on lands in the *pays d'état;* and the *taille personnelle,* nominally a general property tax levied in the *pays d'élection* which constituted the greater portion of France. In reality the *taille personnelle* was assessed only on the families or households of the non-nobles (*roturiers*), and it became practically a land tax like the *taille réelle;* for the wealthy owners of personalty soon acquired the same privileges as the nobility. Vauban tells us that the *taille* as a tax on movables was assessed only on the poorest classes.[4] Sully, indeed, endeavored in 1660 to

[1] Turner, *op. cit.*, p. 159.

[2] *Ibid.*, pp. 164, 165, 183.

[3] *Ibid.*, p. 167.

[4] "En résumé la taille était un impôt territorial qui n'atteignait que les propriétaires les plus pauvres du royaume, et une taxe mobilière qui portait exclusivement sur les classes les moins riches de la société." *Dîme royale,* p. 32 of Daire's edition.

restore the principles of the general property tax and to assess personalty as well as realty.[1] But he failed ignobly; for, at the close of the seventeenth century, the great work of Boisguillebert is full of bitter complaint and lamentation.[2] And when the attempt was made in the eighteenth century to supplement the *taille* by the *dixièmes* and *vingtièmes*, like the tenths or fifteenths of old in England, the new tax again soon became virtually a land tax.[3] The development was inevitable, and it resulted during the Revolution in the total abolition of the general property taxes.

In Germany, the mediæval assessment lists to be filled out by the taxpayer bear a striking resemblance to those still used in some of the American commonwealths.[4] But there, as here, it became continually more difficult to reach personal property. In Prussia (Brandenburg) this was true already at an early period.[5] In Bavaria as well as in Austria the nobility and the richer commercial class succeeded at the end of the sixteenth century in shoving the main burdens on the shoulders of the rural population.[6] And in the other German states the equal property tax remained so only in name.[7]

In the Netherlands, the general property tax or two hundreth seemed in the seventeenth century to possess some advantages in English eyes. We are told by a pamphleteer that

[1] Sully ordered the officials to assess contributors "à raison de leurs facultés, quelque part qu'elles soient, meubles ou immeubles, héritages nobles ou roturiers, trafic et industrie." *Cf.* Clamageran, *Histoire de l'impôt*, ii., p. 359.

[2] "Il n'y a pas le tiers de la France qui y contribue, n'y ayant que les plus faibles, et les plus misérables; en sorte qu'elles les ruinent absolument." *Le détail de la France*, chap. iii.

[3] "Dans la pratique, l'élément foncier prédominait presque exclusivement." Stourm, *Les finances de l'ancien régime et de la révolution*, i., p. 240. See also Necker, *De l'administration des finances de la France*, i., p. 159. It must be noted, however, that these taxes were calculated on the basis of income, rather than of selling value. For details, see Seligman, *The Income Tax*, 2d ed., 1914, pp. 51–53.

[4] For a typical list of 1531, see Bielfeld, *Geschichte des maydeburgischen Steuerwesens von der Reformationszeit*, pp. 19–23.

[5] Schmoller, "Die Epochen der preussischen Finanzpolitik," in his *Jahrbuch*, i., pp. 42, 49. *Cf.* his "Studien über die wirthschaftliche Politik Friedrichs des Grossen," in the *Jahrbuch*, viii., p. 38, for Brandenburg; viii., p 1011, x., p. 330, and x., p. 350, for Magdeburg. *Cf.* also F. J. Neumann, *Die persönlichen Steuern vom Einkommen*, 1896, p. 232.

[6] Hoffmann, *Geschichte der direkten Steuern in Baiern*, p. 70.

[7] Wagner, *Finanzwissenschaft*, iii. (1st edition), pp. 62, 77, 80.

"The two hundredth part is assessed upon the whole bulke of a mans substance so that whoever is worth two hundred shillings or in pounds payes in one to the treasury, for foure hundred and so proportionably: but some may say, how can the magistrate make a true estimate of every mans private fortunes? Since none easily betray their opulence or indigence; whence may be infer'd, that the magistrate often declines the way of equity, seeing it cannot be but that some will passe for poorer, others for richer than indeed they are. This difficulty is prevented by a prudent temper and moderation. . . . Most men being ambitious and having the repute of opulent, many from whom the magistrate exacts too much, chuse rather to pay then proclaime the slendernesse of their fortunes. So that vice itselfe supports vertue and reall profit is reaped from wealth imaginery." [1]

Half a century later, however, the testimony of writers on the spot shows that the general property tax in Holland worked just as badly as elsewhere. We hear that:

"Finally, in an extreme necessity of money, there may be impos'd a general tax on all the moveable and immoveable estates of the inhabitants. I say in an unusual great necessity, because by these taxes there would fall a greater hardship upon the common inhabitants than could fall by any other expedient of this nature. And seeing the assessors are wholly ignorant of mens personal estates or what the inhabitants do owe, or is owing to them; and if they did know the value of them yet could they not tax them so equally as may be done in the case of immoveable goods: We may therefore easily see, what by favour and hatred, and by ignorance of the assessors, that there must be an intolerable inequality in bearing this tax. Those that would honestly declare their estates might lighten the tax; but the fraudulent will unavoidably make it heavier." [2]

In Italy the development of the property tax can be clearly studied in Florentine history. The *estimo*, at first assessed with comparative equality, soon became honeycombed with abuses. Personalty slipped out of the lists, the rich bankers entirely escaped, and the whole load of taxation fell with crushing force on the small owners, *populo minuto*. Hundreds were completely ruined and compelled to seek refuge in exile.[3] The

[1] *The City Alarum or the Weeke of our Miscarriages, etc., whereunto is annexed a treatise of the Excize*, London, 1645, pp. 29.

[2] *The True Interest and Political Maxims of the Republick of Holland and West Friesland.* By John DeWitt, and other Great Men in Holland, London, 1702, pp. 109–110.

[3] *Cf.* Léon Say, *Les solutions démocratiques de la question des impôts*, i., p. 209 *et seq.*, especially pp. 222, 229. He gives no references. For a full history, see Baer, "*Il Catasto Fiorentino nel secolo* xv.," *Nuova Antologia*

discontent became so loud that after threats of revolution and disorder the *estimo* was finally supplanted in 1427 by the new tax, *catasto,* to be levied on the personalty of traders and bankers as well as on realty. Machiavelli gives us an interesting account of the opposition of the nobles, who were at the same time great financiers.[1] But the new general property tax went the way of its predecessors. When we read of the subterfuges and evasions, of the strenuous efforts on the part of the state to compel the listing of personalty and of the dismal failure of the attempts, we seem to be reading the present-day reports of American commonwealth assessors or comptrollers. Their experience was precisely the same as ours. In 1431 only fifty-two persons paid the tax on trade capital, although the amount of such capital must have been immense. And in 1495 the tax was made in name, what it had long been in fact,[2]—a tax on immovables only. Personalty, as such, was henceforth legally exempt. The general property tax had again become a land tax.

Throughout Europe the local property tax also has become a tax on real estate. In England the whole system of local taxation is based on the poor rate, according to the statute of 1601 which mentioned as liable to the tax not only occupiers of lands, houses, *etc.*, but every inhabitant, parson and vicar. The tax was a general property tax levied according to the ability of the individual, *ad statum et facultates,* as the courts put it. At first land was assessed, as everywhere else at the beginning, simply according to the number of acres; but by the time of William III., rental value was substituted for mere quantity as the test of ability. Since personal property also was taxable, this was, however, simply a general property tax. Yet from an early period the rule was adopted that all personal property liable must be local, visible and productive of a profit.[3] Thus intangible personalty, tangible personalty kept in the owner's hands, earnings from personal abilities, and profits from moneys invested or lent at interest in another parish were exempt as being either unproductive, invisible, or not possessing

vol. 17 (1871) and the book of Canestrini quoted in the next note but one.

[1] *History of Florence,* iv., p. 14 (vol. i., p. 181 of Detmold's translation).

[2] Canestrini, *La Scienza e l'Arte di Stato. L'Imposta sulla Richezza Mobile ed Immobile* (1867), i., pp. 108, 115, 321, *etc.*

[3] In 1633 it was decided that "the assessments are to be according to the visible estates, real and personal, of the inhabitants." Sir Anthony Earby's Case, 2 Bulstrode, 354.

a local *situs*.[1] The only property not excluded by these conditions was stock in trade, but it was not until the industrial revolution toward the close of the eighteenth century that the matter became of importance. Lord Mansfield in 1775 showed the impolicy of such action;[2] but although the liability of stock in trade was hotly disputed, it was affirmed by Lord Kenyon in 1795.[3] The results were doubly disastrous in the places where it was tried: the early success of the experiment led the justices of the peace to begin that improvident method of poor relief known as the allowance system;[4] and the practice of rating stock in trade, which was confined to the old clothing district in the south and west of England, resulted in the rapid decline of the ancient staple industry and a transfer of the business to Yorkshire, where personalty was not assessed.[5] When the principle was tested in another district in 1839, the courts again upheld the practice.[6] As a consequence, a law was passed which exempted personalty from taxation,[7] but it was powerless to bring the trade back to its old channels. The exempting law was enacted for only a year, but it has been annually renewed ever since.[8] Thus for the last half century the local property tax in England has been legally as well as actually a tax on productive real estate alone.[9]

[1] *Report of the Poor Law Commissioners on Local Taxation*, 1843, 8vo edition (1844), p. 43 *et seq.*, and especially pp. 34–38. This contains an excellent history of local taxation in Great Britain. A more recent work is Edwin Cannan, *The History of Local Rates in England*, 1896 (2d ed., 1912).

[2] Rex *vs.* Ringwood, 1 Cowp. 326.

[3] Rex *vs.* Mast, 1 Bott. 204. For a detailed statement of the case see Appendix A to the *Report of the Poor Law Commissioners on Local Taxation*, 1843, nos. 35–94. The existence of the general property tax can still be seen in 1791. *Cf.* Rex *vs.* White, 4 T. R. 771.

[4] By the *Speenhamland Act* of 1795. See *First Annual Report of the Poor Law Commissioners*, 1835, p. 207.

[5] *Report of the Poor Law Commissioners on Local Taxation*, 1843, 8vo edition, p. 38.

[6] Queen *vs.* Lumsdaine, 10 Adol. and Ellis, 157.

[7] 3 and 4 Vict., chap. 89, provided that it should not be lawful "to tax any inhabitant in respect of his ability derived from profits of stock in trade or any other property," except "lands, houses, tithes impropriate, propriations of tithes, coal mines, or saleable underwoods."

[8] By the Expiring Laws Continuance Act

[9] Thorold Rogers, *Local Taxation, especially in English Cities and Towns*, p. 16. *Cf.* also Cannan, *op. cit.*, *passim;* Noble, *Local Taxation*, p. 58; Palgrave, *Local Taxation in Great Britain*, p. 78; Goschen, *Reports and Speeches on Local Taxation*, p. 50; Phillips, "Local Taxation in England and Wales," in Probyn's *Local Government and Taxation in the United Kingdom*, p. 502;

Scotland has had an especially interesting history because of its later industrial development and of the consequent survival of the old system almost to our own day.[1] The local tax in Scotland, as in England, originated with the Poor Act. The earliest law providing for compulsory in lieu of voluntary contributions was the Vagabound Act of 1574, which authorized the elders and deacons in towns and the headsmen of rural parishes "by their good discretion to tax and stent the whole inhabitants of the parish . . . according to the estimation of their substance." [2] The "stent-roll" was to be revised yearly according to the "increase or diminution of men's goods and substance." In 1649 a more general act was passed empowering the commissioners, when they found the voluntary contributions inadequate, to stent the parishes according to their ability and wealth. In all these matters the criterion of ability was declared to be the "estates and conditions" or the "goods and substance" of the inhabitants.[3] In 1663 the important change was introduced that one half of the charge was to be assessed on lands and only the other half on the inhabitants according to their means and substance. In 1692 this was made a general rule.[4] For a long time the tax included personal estates and even the income of professional classes and artisans.[5] In the various boroughs and parishes the practice was exceedingly diversified, although personal property in most cases slipped out of the assessment. The Act of 1845 granted wide option to the parochial boards. Several alterations were permitted, one of which included an assessment "upon the whole inhabitants according to their means and substance." [6] By 1847 out of 558 parishes that used their rating powers only 71 employed the method of means and substance, the great mass imposing

Bilinski, *Die Gemeindebesteuerung und deren Reform*, p. 35 *et seq.* See also Hedley, *Observations on the Incidence of Local Taxation* (1884), who opposes the exemption of stock in trade and the attempts to get machinery exempted from ratability. *Cf.* G. H. Blunden, *Local Taxation and Finance*, 1895. Some interesting material may also be found in J. J. O'Meara, *Municipal Taxation at Home and Abroad*, 1894.

William Kennedy, *English Taxation, 1640–1799*, London, 1913, pp. 20, 47, thinks that I have not allowed sufficiently for the income idea in the mediæval property taxes. But see Bruno Moll, *Zur Geschichte der englischen und amerikanischen Vermögensteuern*, 1912, esp. pp. 17–35 where my conclusions are confirmed.

[1] *Cf.* especially the work of Turner, cited *supra*, p. 49, note 3.

[2] *Ibid.*, p. 14. [3] *Ibid.* [4] *Ibid.*, pp. 21, 34.

[5] *Ibid.*, p. 38. [6] *Ibid.*, pp. 44–45.

the tax on real estate, one-half on owners and one-half on occupiers. By 1860 out of 752 parishes only 25 used the "means and substance" method. In 1861 the Baxter Act abolished rating on means and substance in all parishes where it had been introduced since 1845. A very few parishes retained the system by right of usage previous to 1845, the last to maintain the custom being Greenock, where it continued to exist according to a curiously progressive scale, until 1880.[1] The system was abolished because it was finally realized by the owners of real estate that the exemption of personalty really increased, rather than diminished, the value of their own real property.[2] Thus came to an end the local general property tax in Scotland. As we have seen above,[3] it was only a few years more before the state general property tax followed suit.

History thus everywhere teaches the same lesson. As soon as the idea of direct taxation has forced itself into recognition, it assumes the practical shape of the land tax. This soon develops into the general property tax which long remains the index of ability to pay. But as soon as the mass of property splits up, the property tax becomes an anachronism. The various kinds of personalty escape, until finally the general property tax completes the cycle of its development and reverts to its original form of the real property tax. The property tax in the United States is simply one instance of this universal tendency; it is not an American invention, but a relic of mediævalism. In substance, although not in name, it has gone through every phase of the development, and any attempt to escape the shocking evils of the present by making it a general property tax in fact as well as in name is foredoomed to failure. The general property tax as the chief source of revenue is impossible in any complicated social organism. Mediæval methods cannot succeed amid modern facts

V. *Theory of the General Property Tax*

While it is generally confessed that the property tax, as administered in the United States, is a failure, it is sometimes contended that if thoroughly executed it would be a just tax.[4]

[1] *Ibid.*, pp. 48–49. [2] *Ibid.*, p. 52. [3] *Supra*, p. 50.

[4] "While there is no fairer or better mode of taxation than the *ad valorem* system properly and justly administered, there is none more oppressive or unjust and unequal when loosely or imperfectly executed." *Report of the Comptroller-General of Georgia*, 1894, p. 5.

The theory of the general property tax designed as the sole or principal source of state and local revenue, as set forth in almost all our state constitutions, is held to be correct in principle. Is this true?

In the first place we must disabuse ourselves of the idea that property, as such, owes any duty to pay taxes. The state has direct relations not with property, but with persons. It is the individual who, from the very fact of his existence within the state, is under definite obligations toward the state, of which the very first is to protect and support it. The state, indeed, can exist without the particular individual, but the individual cannot exist without the state. Every civilized community professes to tax the individual according to his ability to pay, which may, indeed, be measured by his property or by any other standard. In the last instance, however, it is the individual who really owes this duty.

But is property the true test of ability? In primitive communities it is to a certain extent. Every freeman is a proprietor, and all are supported by the produce of the land. Comparative equality of wealth gives comparative equality of opportunity, and the finer differences in ability to pay are not yet recognized. In the early stages of society property is indeed a rough test of ability.

But a change soon sets in. As society differentiates, classes arise who support themselves not from their property, but from their earnings. Manifestly he who earns a salary cannot be declared entirely devoid of ability to pay, as compared with one who receives the same amount as interest on a principal, or as profits on property. Moreover, the productiveness of property becomes a controlling element in calculating the owner's ability. Of two factory owners, one may be running full time and making large profits; the other may be compelled to keep his factory closed, earning nothing. Of two landowners, one may employ improved processes and enjoy a large product; the other, although on equally valuable land, may suffer climatic reverses and produce far less. Of two capitalists, one may invest his property so as to obtain large proceeds; the other may put an equal amount into an enterprise which yields very little. It is plainly incorrect to say that the ability in these cases varies with the property. The test of ability is shifted from property to product, proceeds or earnings.

The truth of this principle is faintly recognized in the legis-

lation of all countries one step removed from the primitive tax system. Its application can be seen in some of the mediæval town taxes, where the earnings of the artisans and tradesmen were taxable, as evidences of ability or faculty, side by side with the property of others. It can be seen also in various attempts of mediæval states to tax the proceeds or rents of land, the salaries of officials and the products of individual exertion. In like manner, it can be seen in the early legislation of the American colonies. Thus the law tax of 1634 in Massachusetts Bay provided for the assessment of each man "according to his estate and with consideration of all other his abilityes whatsoever." The measure of ability, however, was still property, as appears from the provision of 1635 that "all men shall be rated for their whole abilitie, *wheresoever it lies*." By 1646, the glimmering of the new idea is seen; for the law now provides not only for rating of all "estates, both real and personal," but also for the taxation of "manual persons and artists," who "are to be rated for returns and gains proportionable unto other men for the produce of their estates." In other words, not only property but product was taken into account. In many of the other American colonies, also, the profits of certain classes were taxable like the produce of estates, by what was known as the faculty tax or the assessment on the faculty.[1] We see, therefore, how wide of the mark is the statement that the system which the Americans instinctively adopted was "the equal taxation of property, the non-taxation of labor."

In the colonies, indeed, these laws mark only the first faint attempts to substitute product for property as the basis of taxation. Later on, the distinction was lost sight of and the attempt abandoned. But in Europe the development continued and the basis of the tax system was changed from property to product. Thus taxes on land, houses, wages, salaries, interest, profits, *etc.*, gradually supplanted the property tax, and formed a more or less complete system based on product. In modern societies, as we have seen, the basis of taxation has very recently again shifted from product to income. The point here to be noticed is that throughout all Europe the mediæval basis of taxation—the mass of property—was abandoned because it no longer corresponded to the demands of justice. The property tax is theoretically unjust because property

[1] For the details of this development see Seligman, *The Income Tax*, 1911, 367 *et seq.*

no longer measures the ability to pay—because property has been replaced by product as an index to faculty.

This is the reason for the failure of the property tax. It has, indeed, been contended by some, as, for instance, by President Walker, that the fatal defect of the property tax consists in its constituting a penalty on savings.[1] This criticism seems to be questionable, for the same objection would attach to any tax based on income just so far as income exceeds expenditures. An income tax on the surplus is equally a tax on savings. There is no difference in this respect between a property tax and this portion of an income tax. The only logical conclusion from this objection to the property tax is a tax on expense. If we wish to avoid taxing savings, we must tax only expenditure. And yet President Walker correctly opposes the expense tax as the most unjust of all. The property tax is unjust, not because it is a penalty on savings, but because property is no longer a measure of ability.

There is not a single scientist of note who upholds the property tax as the sole or chief direct contribution. Some of the German writers on finance do, indeed, advocate a general property tax, but simply as a subordinate supplement to all existing direct taxes,[2] and mainly as an adjunct to the income tax, in order to tax income from property more than professional or individual earnings. These writers, however, overlook the fact that the same result may be attained by making a difference in the rate of the income tax, as in Italy. The *post-bellum* examples of the taxation of property in the shape of a capital levy as in Germany and Italy in 1920 not only constitute supplementary sources of revenue but are obviously emergency measures and not subject to repetition.

One other argument of somewhat more weight is sometimes advanced in favor of the property tax, *viz.*, that under any other system unproductive property, like jewellery, art collections, unimproved lands, *etc.*, would be exempt. This consideration at its best does not justify a general property tax, but a tax on special kinds of property. Entirely apart from the impolicy of taxing art collections, or the impossibility of

[1] *Political Science Quarterly*, vol. iii. (1888), p. 3.

[2] *Cf.* Gustav Cohn, *Finanzwissenschaft*, § 475: "Neben der Erwerbsbesteuerung bleibt für die Besitzbesteuerung heute nur ein beschränkter Raum übrig." See the English translation, p. 566: "The taxation of earnings as it exists to-day leaves but scant room for taxes on possessions."

discovering jewellery, or the utter insignificance of this kind of property when compared with the total national wealth, the argument is defective. The conversion of capital into unproductive wealth of itself destroys the revenue, which is the only true fund for the payment of taxes. It is undeniable that if the property were productive, and if the tax were levied on the product, the owner would pay a larger sum. But on the other hand, his revenue would be still greater and his annual surplus above the tax would constitute an ever-increasing productive fund. To leave unproductive property free may thus indeed lessen the share of the government, but seems to be nothing more than justice to the individual. His renunciation of revenue diminishes *pro tanto* his tax-paying ability. It is really only because of the belief that the possession of these articles of consumption involves an expenditure for their maintenance, or forms an indirect proof that their owner is able not only to retain these articles of luxury, but also to live in comfort on his income, that we attempt to tax this kind of property. In other words, just as relative expenditures of certain kinds afford a rough criterion of a man's income, because his standard of living usually bears a fairly definite relation to his income, so the taxation of special articles of property may really be considered an indirect way of getting at relative revenue. But precisely because it is very rough and indirect, it is in the main unsatisfactory.

The great element of reason in the demand for the taxation of unproductive property is to be found in the assessment of real estate. It is an undoubted fact that real estate is often held for speculative purposes, and that it is the duty of the community not to encourage such speculation by exempting vacant lands from taxation. The owner expects to reap from the future value of the land, whether he sells or keeps it, a sum more than sufficient to recompense him for his outlay and intervening loss of interest and profit. He is prospectively earning an annual revenue from the land, whose present unproductiveness is technical rather than real. It is thus perfectly logical to tax unproductive real estate even though the basis of taxation be product rather than property. It is the estimated, rather than the actual, product that is taxed.

But even granting that there is this justification for a tax on certain forms of unproductive property, it would not strengthen the case for a general property tax. At best it would simply

mean that the tax on product should be supplemented by a tax on certain kinds of unproductive property, which are really prospectively productive. No one has ever objected to a real estate tax, whether it be levied on the basis of value or of assumed product. But a real estate tax is not a general property tax; the principle of the real estate tax does not signify that property in general should be made the test of ability to pay. We may, therefore, still assert that if there are any evils arising from the absence of a general property tax, they are slight when compared to the evils inseparable from its existence.

VI. *Conclusion*

From the preceding survey it is difficult to escape the conclusion that the general property tax as the main source of public revenue is a failure from the triple standpoint of history, theory and practice.

Historically, the property tax was once well-nigh universal. Far from being an original idea which the Americans instinctively adopted, it is found in all early societies whose economic conditions were similar to those of the American colonies. It was the first crude attempt to attain a semblance of equity, and it at first responded roughly to the demands of democratic justice. In a community mainly agricultural, the property tax was not unsuited to the social conditions. But as soon as commercial and industrial considerations came to the foreground in national or municipal life, the property tax decayed, became a shadow of its former self and, while professing to be a tax on all property, ultimately turned into a tax on real property. The disparity between facts and appearances, between practice and theory, almost everywhere became so evident and engendered such misery, that the property tax was gradually relegated to a subordinate position in the fiscal system, and was at last completely abolished. All attempts to stem the current and to prolong the tax by a more stringent administration had no effect but that of injurious reaction on the *morale* of the community. America is to-day the only great nation deaf to the warnings of history. But it is fast nearing the stage where it, too, will have to submit to the inevitable.

Theoretically, we have found that the general property tax is deficient in two respects. First, the theory presupposes that there is an ascertainable general property—a definite surplus of assets over liabilities. In primitive social conditions this is

true; there is a composite mass of property, because there is no industrial differentiation. But in the modern age property is split up into a hundred elements, so that if we attempt to tax each element separately, it is often impossible to decide from which category deductions are to be made for indebtedness. An individual, for instance, owes more on his book accounts than is due to him. Granting that he therefore pays no tax on his book accounts, shall he be permitted to deduct this surplus of debt from the value of his real estate? This is manifestly inadmissible. And yet unless this is done he is taxed not on his property, but on his surplus of debt—not on his real assets, but on what he owes; not on his ability, but on his liability. The theory of the property tax is not carried out; and it cannot be carried out because the conditions of the theory fail. The general mass of property has disappeared, and with it vanishes the foundation of the general property tax.

Secondly, the property tax is faulty, because property is no longer a criterion of faculty or tax-paying capacity. Two equal masses of property may be unequally productive, and hence unequally affect the margin of income from which the public contributions are paid. The standard of ability has been shifted from property to product; the test now is not the extent, but the productivity, of wealth. And since revenue is a better index than wealth, the vast class of earnings derived not from property but from exertion is completely and unjustifiably exempted by the taxation of property alone. The theory of the property tax again fails because the conditions of the theory have disappeared.

Practically, the general property tax as actually administered is beyond all doubt one of the worst taxes known in the civilized world. Because of its attempt to tax intangible as well as tangible things, it sins against the cardinal rules of uniformity, of equality and of universality of taxation. It puts a premium on dishonesty and debauches the public conscience; it reduces deception to a system, and makes a science of knavery; it presses hardest on those least able to pay; it imposes double taxation on one man and grants entire immunity to the next. In short, the general property tax is so flagrantly inequitable, that its retention can be explained only through ignorance or inertia. It is the cause of such crying injustice that its alteration or its abolition must become the battle cry of every statesman and reformer.

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CHAPTER III

THE SINGLE TAX

AMONG the projects for social and tax reform, few have been more earnestly and enthusiastically supported than the single tax. Many persons, however, have only a faint idea of what the project really is; while others have been so influenced by the alluring arguments of its advocates, that they have not troubled themselves to investigate the problem from the standpoint of modern economic science. Let us attempt, in the following pages, to explain the nature of the single tax and to consider critically the arguments that are commonly urged in its favor.

I. *What is the Single Tax?*

In the first place, the single tax denotes, as its name implies, the only tax, the exclusive tax, the tax on some one class of things. The idea that the wants of the state may be supplied by such a tax is not a new one. During the seventeenth and eighteenth centuries, a band of reformers in England as well as on the continent put forward the idea of a single tax on expense.[1] So many of the privileged classes had succeeded in securing exemption from the various direct taxes, that it was hoped to realize a substantial universality of taxation by taxing everybody on his expenditure; and since it was supposed that this tax could be evaded by no one, it was for a time very popular. Later on in the eighteenth century there was a party in England whose motto was a single tax on houses.[2] Again, at the beginning of the nineteenth century the experience of England with the income tax led a number of writers on the continent to advance the plan of a single tax on incomes.[3] Toward the middle of the century, again, a single stamp tax was advocated

[1] *Supra*, p. 8. [2] *Cf.* Seligman, *The Shifting and Incidence of Taxation*, 4th ed., 1921.

[3] For the first suggestion of this see *An Essay on the Inequality of our Present Taxes*, 1746. For the German advocates see Seligman, *The Income Tax*, 2d ed., 1914, pp. 234–236.

in France,[1] and a generation later, the project of a single tax on capital was enthusiastically advocated not by socialists, but by conservative reformers.[2] The single tax proclaimed by Henry George ~~is thus simply~~ the last of many similar schemes that have been propounded; and it is not improbable that after it has disappeared economists of the future will be occupied in dealing with yet another form of single tax.

The present scheme is a single tax on land values—that is, a tax on the value of the bare land irrespective of the buildings or other improvements in or on the land. Curiously enough the taxation of land has been supported by two lines of argument which are fundamentally opposed. Thus about a generation ago Mr. Isaac Sherman, an eminent citizen of the city of New York, proposed a plan by which all state and local taxes at least were to be levied on real estate. Mr. Sherman and his followers confessed that taxes ought to be borne by the whole community. They favored the taxation of land on the theory that the tax would be shifted from the landowner to the consumer, and would thus be diffused throughout the community. As every one is a consumer, each would in the end bear his share of the burden. The tax would, moreover, have the additional merits of simplicity and convenience.

Many people to-day declare their adhesion to a tax on land for this reason. But it is remarkable that what constitutes the chief advantage of the tax in the eyes of this party is regarded in precisely the opposite way by the real advocates of the single tax on land values. Mr. Sherman said that the tax on real estate is to be recommended because it falls only nominally on the owner, and is in fact shifted to the consumer. Mr. George said that the tax on land values will stay where it is put, namely, on the landowner, and that it is to be recommended precisely because it will *not* be shifted to the consumer. The difference between the two theories could not be more fundamental.

As between these two theories, there is a substantial consensus of opinion among economists that Mr. George is correct. From the time of Ricardo, it has been well-nigh universally confessed that a tax on land values, *i.e.* a tax on economic rent,

[1] Alexis Wilhelm, *Projet d'impôt unique universal sur la fortune publique.* Paris, 1850.

[2] Especially Menier and his followers. For these see Seligman, *The Income Tax*, 2d ed., 1914, p. 290.

will fall wholly on the owner.[1] This is precisely the reason why the scheme is advocated by the single-taxers, who desire to tax the landowner out of existence—to take away from the owner of the land all his revenue rights in the land. The essential antagonism between the two schemes, therefore, cannot be emphasized too strongly. The one desires a land tax because it will be borne by the whole community; the other desires a tax on land values because it will be borne *not* by the whole community, but by a particular class. Yet many persons who really favor the former theory mistakenly give their adhesion to the latter. There are many self-styled single-taxers who simply believe that a land tax is the most convenient of all methods for securing the desired equality of burden. In reality, there is no kinship between them and the single-taxers proper. Mr. George warns us not to confuse a tax on land with a tax on land value.

Another point which needs especial emphasis is the distinction to be observed between the single tax and a tax on land values. The single tax with which we have to deal is indeed a tax on land values, but a tax on land values is not necessarily a single tax. The essential feature of the single tax is the singleness of the tax—the demand for the abolition of all other taxes and the substitution of a tax on land values. This is something quite different from the demand for a tax on land values as a supplement to other taxes. The addition in recent years of a tax on land values to the tax systems of various countries must not be interpreted to be an acceptance of the single-tax philosophy. The more modern advocates of the "single tax limited," *i. e.* a local tax on land values plus a state tax on corporations, plus perhaps a national income tax are really not single-taxers at all. The distinction between the single tax and a tax on land values is of fundamental importance.

II. *The General Theory*

The general economic theory on which the demand for the single tax is based may be summed up in a few words. Land is the creation of God; it is not the result of any man's labor; no one, therefore, has a right to own land. Increase in the value of land is due mainly to the growth of the community; like the land itself, it is not the result of any individual effort; it is an unearned increment which properly belongs to society. More-

[1] See Seligman, *The Shifting and Incidence of Taxation*, 4th ed., 1921, pp. 281–287.

over, private property in land is undoubtedly the cause of all social evils. It therefore becomes the duty of the government to take what rightfully belongs to the whole community. Every one may still retain the result of his own labor; but the value of the bare land, the economic rent, must be taken for the state. In this way, and in this way alone, can the social problem be solved. The consequences are epitomized as follows in the platform of the Single Tax League: "It would solve the labor problem, do away with involuntary poverty, raise wages in all occupations to the full earnings of labor, make over-production impossible until all human wants are satisfied, render labor-saving inventions a blessing to all, and cause such an enormous production and such an equitable distribution of wealth as would give to all comfort, leisure, and participation in the advantages of an advancing civilization."

This is an inviting prospect. It is not so much a method of tax reform, as a panacea for human ills, that is here set forth. It would be interesting to discuss this fine fabric of the ideal. But we must be more modest and confine our attention to the scheme primarily as a practical method of tax reform.

In order to attain a basis for this discussion, it is necessary to allude to the two fundamental doctrines on which the plan is founded. The first is the underlying theory of private property; the second is the theory of the relation of the individual to the public purse.

In the first place, the single-tax theory of property is the labor theory—the theory that individual human labor constitutes the only clear title to property. It would be interesting, were there space, to trace the genesis of this doctrine. The Romans, as is well known, had an entirely different theory—the occupation theory, based on the right of the first occupant. Against this rather brutal doctrine, which in the early middle ages paved the way for intolerable abuses, the philosophers advanced the labor theory, hoping thereby to bring about a reform in actual institutions. The labor theory went hand in hand with the doctrine of natural rights, which was the result of an earnest attempt to abolish the abuses of the *ancien régime*, and which came to a climax in the eighteenth century. Modern jurisprudence and modern political philosophy, however, have incontestably proved the mistake underlying this assumption of natural law or natural rights. They have shown that natural law is simply the idea of particular thinkers of a particular age of

what ought to be law. These particular thinkers, indeed, often influence the social consciousness, as they in turn are influenced by it, so that natural law may be called law in the making. But at any given time it represents simply an ideal. Whether that ideal will approve itself to society depends on a variety of circumstances, but chiefly on the question whether society is prepared for the change. Just as the modern theory of jurisprudence is sociological in character, so also the modern theory of property may be called the social utility theory.[1]

The social utility theory says that just as all law, all order and all justice are the direct outgrowths of social causes, and just as private ethics is nothing but the consequence of social ethics, so private property is to be justified simply by the fact that it is the last stage of a slow and painful social evolution. At the outset, property, and especially property in land, was largely owned in common. It was only through the gradual progress of economic and social forces that private property came to be recognized as tending on the whole to further the welfare of the entire community. The social utility theory does not, of course, mean that what has once been must always be. It is not a reactionary doctrine which looks upon all that is as good. It simply maintains that the burden of proof is always upon the party urging the change; and that when the change advocated is a direct reversal of the progress of centuries, and a reversion to primitive conditions away from which all history has travelled, the necessity for its absolute proof becomes far stronger. The nationalization of land is a demand which, in order to win general acceptance, must be based on theories independent of the doctrine of natural rights.

Even though we accept the theory of natural rights, we need not therefore accept the single tax. If it is said that the value of land is the work of the community, and that in consequence every one has a natural right to it, how can we logically deny that the value of any so-called product is, at least partly, the work of the community? Mr. George bases his defence of private property in commodities other than land on the labor theory. Yet individual labor, it may be said, has never by itself produced anything in civilized society. Take, for example, the workman

[1] For a good exposition of the insufficiency of the doctrine of natural rights, a discussion of which would be out of place here, the reader is referred to Ritchie, *Natural Rights*, 1895; and, with special reference to the land question, to Huxley's essay on "Natural Rights," in his *Collected Essays*.

fashioning a chair. The wood has not been produced by him; it is the gift of nature. The tools that he uses are the result of the contributions of others; the house in which he works, the clothes he wears, the food he eats (all of which are necessary in civilized society to the making of a chair), are the result of the contributions of the community. His safety from robbery and pillage—nay, his very existence—is dependent on the ceaseless co-operation of the society about him. How can it be said, in the face of all this, that his own individual labor wholly creates anything? If it be maintained that he pays for his tools, his clothing and his protection, it may be answered that the land-owner also pays for the land. Nothing is wholly the result of unaided individual labor. No one has a right to say: This belongs absolutely and completely to me, because I alone have produced it. Society, from this point of view, holds a mortgage on everything that is produced. The socialists have been in this respect more logical; and that perhaps explains why the movement to which Mr. George gave such an impetus in England and elsewhere is fast changing from one in favor of land nationalization into one for nationalization of all means of production. The socialists, indeed, as well as Mr. George, are in error, because the premises of each are wrong. It is not the labor theory, but the social utility theory, which is the real defence of private property. But if we accept the premises of the single-taxers, we are inevitably impelled to go further than they do. The difference between property in land and property in other things is from the standpoint of individual *versus* social effort simply one of degree, not of kind.

The other fundamental doctrine of the advocates of the single tax is the theory of benefit,—the doctrine that a man ought to contribute to public burdens in proportion to the benefits that he receives. The theory is that, since the individual gets a special advantage from the community in the shape of unearned increment, he ought to make some recompense. To this contention, two answers may be made: first, that the benefit theory of taxation is inadequate; and second, that, even if it were true, it would not support the single tax. Let us take up these in turn.

It is pointed out in another chapter that the payments made by the individual to the government are exceedingly diverse in character.[1] Where the government acts simply as a private individual, in performing certain services for the citizen, the

[1] *Infra*, chap. xiv.

payment is a price. It is a case of *do ut facias*. The government does something; the individual gives something. Again, even after common interests have developed, the individual may ask the government to do some particular thing for him, to confer some privilege upon him. He may wish to get married or to run a cab. For this particular privilege it is perfectly proper that the government should make a charge—known in modern times as a fee or toll. Again, the government may be at considerable expense in laying out a new street, the result of which will be to enhance the value of a particular plot of ground. There is here no reason why the government should not demand that the owner of this plot should defray, at all events in part, the cost of this improvement. This is called a special assessment. In all these cases the individual receives an undeniable, special benefit as the result of a special expenditure made, or privilege conferred, by the government. The principle of give and take, therefore, is applicable.

On the other hand, there are certain actions of the government which interest the whole community, and from which the individual receives no benefit, except what accrues to him incidentally as a member of the community. If the government undertakes a war, no one citizen is benefited more than another. If the government spends money for instituting a public school system, for erecting tribunals, or for preserving the public health, it cannot be claimed that any one individual receives a measurable, special benefit; all are equally interested in good government. When payment is made for these general expenditures—and such a payment is called a tax—the proper principle of contribution is no longer that of benefits or of give and take, but of ability, faculty, capacity. Every man must support the government to the full extent, if need be, of his ability to pay. He does not measure the benefits of state action to himself first, because these benefits are quantitatively unmeasurable; and secondly, because such measurement implies a decidedly erroneous conception of the relation of the individual to the modern state.

At one time the doctrine of benefit had a relative justification. Two centuries ago, when the absolute rulers of central Europe loaded down their subjects with grievous burdens and devoted the profits to their own petty pleasures—when in France, for example, the peasant was taxable *à merci et miséricorde* of the nobility—it was natural that a school should arise to pro-

test and to proclaim the principle of benefits. Their argument was that as the state protects everybody, everybody is under a duty to pay taxes; in other words, their plea was for universality of taxation. This was a distinct step in advance. Later on, however, the doctrine was stretched to assert that everybody should pay in proportion to benefits received, with the implication that if the state could not be proved to confer any special benefit on the individual, he should not be held to pay anything.

As thus extended, the theory has been rejected by well-nigh all the thinkers of the last fifty years. It is now generally agreed that we pay taxes not because the state protects us, or because we get any benefits from the state, but simply because the state is a part of us. The duty of supporting and protecting it is born with us. In civilized society the state is as necessary to the individual as the air he breathes; unless he reverts to stateless savagery and anarchy he cannot live beyond its confines. His every action is conditioned by the fact of its existence. He does not choose the state, but is born into it; it is interwoven with the very fibres of his being; nay, in the last resort, he gives to it his very life. To say that he supports the state only because it benefits him, is a narrow and selfish doctrine. We pay taxes not because we get benefits from the state, but because it is as much our duty to support the state as to support ourselves or our family; because, in short, the state is an integral part of us.

The principle of benefit, moreover, would lead us into the greatest absurdities. If we accept it, we must apply it logically; we must not restrict its beneficent workings to the landowner. As has been pointed out in another place,[1] the poor man, according to the theory of benefit, ought to be taxed more than the rich, because he is less able than the rich man to protect himself. It is, however, needless to discuss this point because, as we have seen in a previous chapter, so far as the individual is concerned, ability to pay is not only the ideal basis of taxation, but the goal toward which society is steadily working. It lies instinctively and unconsciously at the bottom of many of our endeavors at reform. When we say that indirect taxes are often unfair to laborers, we mean that they are less able than the wealthier portion of the community to

[1] *Cf.* Seligman, *Progressive Taxation in Theory and Practice*, 2d ed., 1908, pp. 150–157.

pay the tax. When we say that a corporation with large receipts should pay more than one with small receipts, we do so because we know that its ability to pay is greater. The principle of benefit is, therefore, not the basis of taxation. It is the principle away from which all modern science and progress have been working. It is founded on a false political philosophy, and it can result only in a false political economy.

It may be contended, however, that the doctrine of the single-taxers is really somewhat different, and that what they desire to emphasize is the principle of privilege or opportunity, rather than that of benefit. This, however, does not really help their case. It is undeniable that privilege constitutes an important factor in the tax problem; but correctly interpreted, privilege as we shall see in a subsequent chapter,[1] is simply an element in taxable ability. The lucrative privileges that are conferred on an individual increase his income or his property, and to that extent augment the modern index of his taxpaying ability. There is therefore no real opposition between the two conceptions; but it is obvious that privilege is the minor factor, ability the major. Privilege is one of the elements that constitute ability, not the sole element.

The result of this consideration is that a tax on land values is legitimate because it reaches one of the elements of taxable ability. But the conclusion follows with equal force that the demand for a single tax on land values is inadmissible. This is true for two reasons: in the first place it emphasizes the principle of privilege to the neglect of all the other constituent elements of faculty; it attempts to erect into the superior position a point of inferior importance; it takes a part and makes of it a whole. In the second place, even if the principle of privilege were put into this position of pre-eminence, the single-taxers err in singling out a particular privilege and basing their system on this, to the exclusion of other scarcely less important privileges. This point will be more fully discussed below, under the head of the justice of the single tax. Thus in a double way the single-taxers have failed to gain the assent of tax scientists and tax reformers. The arguments, which are of unquestioned validity when advanced in favor of the addition of a land-value tax to existing fiscal systems, lose their force in proportion that the emphasis is laid on the desirability of the single tax.

[1] *Infra*, chap. x.

III. *Practical Defects*

Let us now leave the discussion of principles and come to the objections that may be urged against the single tax as a practical method of tax reform. To a certain extent indeed, the paths of American fiscal reformers and of the single-taxers are parallel, so that up to a given point it is the advantages rather than the defects of the single-tax movement that might be emphasized. As we have pointed out in a preceding chapter, the general property tax has become a failure in America. Every serious student agrees that the personal property tax as a part of the general property tax must be abolished. What to put in its stead is another question which need not be touched upon here. But the old must always be demolished before the new can be erected. Now so far as the destructive side is concerned, single-taxers and other tax reformers may go hand in hand. So ingrained is the belief of the average American in the virtue of the general property tax that the united efforts of all are necessary to effect a change. And where, as is sometimes the case, the more moderate single-taxers will go further and advocate practicable substitutes for the present-day property tax, there is still more reason for co-operation.[1] In the struggle against the common enemy there is no time for the combatants on the same side to lay stress on differences of opinion. This explains why it is that in several of the American states the single-taxers and other tax reformers are working in unison. But this harmony is, after all, destined to be only temporary. After a time, when the period for real constructive work arrives, the differences are bound to make themselves felt and the rift will reappear. So that, however greatly we may prize the co-operation of the single-taxers for a time, the emphasis must ultimately again be put on the defects of the scheme as a practical, constructive solution of tax problems. These defects may be summed up under four heads: First, the fiscal defects; second, the political defects; third, the moral defects; and fourth, the economic defects.

1. *Fiscal Defects*

One of the great aims of every sound financial system is to bring about an equilibrium of the budget—that is, to avoid

[1] Among the most interesting and effective of the modern single-taxers is Mr. Fillebrown of Boston. *Cf.* especially his *A. B. C. of Taxation* which has gone through several editions.

a surplus as well as a deficit. Now, while many taxes may be suddenly lowered, not many of them can be made to give a suddenly increased yield. One of the cardinal principles of taxation, therefore, is elasticity. In order to secure this, two conditions are necessary. In the first place, the source from which the tax is derived must be of such a nature that an increase of the rate will always mean an increase of the yield. There should be in the source of taxation a reserve power which can be drawn upon in case of need. Secondly, the revenue should be secured from a number of objects, so that the shrinkages or deficits temporarily due to the one class may be made good by the increase or surplus revenues of the other class. Among the elastic taxes is the income tax, and it is well known that in English finance one of the chief functions of this income tax is to preserve the equilibrium of the budget. So again, certain taxes on commodities are often utilized for this purpose. The single tax on land values, however, is utterly inelastic; for since, according to the theory of its advocates, the total rental value is to be taken from the landowners, the single tax cannot be increased. Where nothing has been left, nothing more can be taken. In the case of an emergency there would, therefore, be no possibility of increasing the revenues. Even if the total land value were not taken, it would still remain true that a direct tax on the unimproved value of land is far more inelastic than other taxes; for when the supply is constant and the price varies with the conditions of demand, the selling value as well as the rental value is subject to far more fluctuations than in commodities where the supply may be altered at pleasure. Furthermore, as we have seen, a single tax of any kind, whether on lands or on anything else, would be less elastic than a system of taxes where one may be played off against the other. Lack of elasticity is a serious defect in the single tax.

Another fiscal weakness of the single tax is that it inevitably intensifies the inequalities resulting from unjust assessments. We all know how difficult it is to carry out laws which provide for equal assessments. Under the real estate tax in the United States, for example, the assessors are usually sworn to rate the property at its actual or selling value, and the selling value of a piece of land or of a house is comparatively easy to ascertain; yet it is notorious that in no two counties, nay even in no two adjoining pieces of property, is the standard of assessment the

same. Thus the report of the Iowa Revenue Commission of 1893, states that realty in Iowa was assessed at from seventeen to sixty per cent of the true value. It is well known, too, that in Chicago adjacent plots of real estate were until recently assessed at percentages of ridiculously varying degree. Now, it is manifestly not so easy to assess the land values,—that is, the bare value of the land irrespective of all improvements,—as it is to assess the selling value of a piece of real estate. For instance, an acre of agricultural land near a large town may be worth $200; but if used for truck-farming, considerably more than $200 may have been expended on it during the last century or two. Who can tell how much of the $200 present value is the value of the bare land and how much is to be assigned to the labor expended? Under the present method we have at least a definite test—the selling value; under the new method we should have no test at all. There is every likelihood, therefore, that the difficulties of the present situation would be intensified. During the past few years a number of American cities and a few states have initiated the system of differentiating between assessments on land values and on improvements. In every case, however, by improvements is meant in practice not the improvements *in* the land, but the improvements *on* the land, and not even all the improvements on the land, but only those consisting of buildings. In the cities this is of course all that is needed; but in the rural districts no effort is made to ascertain land values in the proper sense of the term. Any attempt to do so would at once engender the difficulties referred to above. Moreover, under the present system, inadequate as it is, there is always a chance that the imperfect enforcement of a particular tax law will be offset by the assessment of other taxes, direct or indirect. Under the single tax not only would there be more difficulty than at present in making the original assessment, but any inequality in the assessment would be seriously intensified by the very fact that it is a single tax.

2. *Political Defects*

The adoption of the single tax means the total abolition of all custom houses and import duties; it means that there can be no such thing as a system of protection to home industry. Many would, it is true, favor the single tax precisely on this account; but there are some self-styled "single-taxers" who believe that as a matter of national policy there is a justifica-

tion for import duties. Whatever we may think of the economic justification of import duties, it must be recognized that they may sometimes form an important political weapon. It is clear, however, that leaving the question of protection entirely aside, the adoption of the single tax will make it impossible to utilize import duties for political, fiscal or other purposes.

In the second place, the adoption of the single tax would render it impossible for governments to utilize the taxing power as a political or social engine. For instance, the United States government now imposes a tax on the circulation of state bank-notes in order to bring about certain desirable results in the currency situation. Again, the United States government levies a high tax on opium, not for the purpose of revenue, but in order to discourage the consumption of opium; and it also assesses a tax on oleomargarine, primarily in order to ensure the purity of butter. Under the single tax, all such efforts would be impossible. Finally, to mention only one other example, one of the chief methods of dealing with the drink question is through the imposition of high liquor licenses, the fiscal importance of which is only secondary. Under the single tax we should be prevented from attacking the problem in that way. Governments have always made use of the taxing power to regulate and to destroy, as well as to yield a revenue. Were the single tax to be adopted, this power would be eliminated.[1]

Thirdly, the political results of the single tax would be dangerous in another way. So far as there is any truth in the assertion that in a democracy it involves some risk for a small class to pay the taxes and for a large class to vote them, it is especially applicable to the single tax. Since the "unearned increment" would flow of itself, silently and noiselessly into the treasury, there would be no need of a budget; and the sense of responsibility in the citizens would be perceptibly diminished. It is well known that liberty has been intimately bound up with the contest against unjust taxation; the constitutional history of England is to a large extent a history of the struggle of the people to gain control of the treasury; the American Revolution was precipitated by a question of taxation; the French Revolution was brought about primarily by the fiscal abuses of the *ancien régime*. To take away, then, from the vast majority of

[1] Mr. George indeed states that he does not object to repressive taxes, because neither a land nor a revenue question is involved. But clearly the tax would then not be a "single" tax.

citizens the sense of their obligation to the government and to divorce their economic interests from those of the state would, especially in a modern democracy, be fraught with danger.

3. *Ethical Defects*

The advocates of the single tax love to base their arguments on the ground of justice. In this they are certainly wise; for even though all other arguments were in its favor, if the justice of the single tax could be successfully impugned, it would be foredoomed to failure. Let us then ascertain whether it is indeed true that the single tax is an equitable method of taxation.

The two great canons of justice in taxation are universality and uniformity or equality. If anything has been gained by the revolutions of the eighteenth century and by the growing public conscience of the nineteenth and twentieth, it is a recognition of the fact that all owe a duty to support the state, that a system of wholesale exemptions is iniquitous, and that every taxpayer should be treated according to the same standard. Judged by any or all of these tests, can it be seriously maintained that the single tax is an equitable form of taxation?

Toward the close of the eighteenth century, there was a school of French writers, the Physiocrats, who first advocated the plan of a single tax on land—the famous *impôt unique*. It was considerably talked about until Voltaire turned his caustic pen upon them and wrote the celebrated essay *L'homme à quarante écus*—the man of forty crowns—, one of the most effective bits of mordant sarcasm ever written. Voltaire pictured the position of the French peasant toiling laboriously, amid conditions of unspeakable distress, but succeeding in getting from the soil a product equivalent to forty crowns. The tax-gatherer comes along, finds that the peasant can manage to keep body and soul together on twenty crowns, and takes away the other twenty. Then the peasant meets an old acquaintance, originally poor, who has been left a fortune of 400,000 crowns a year in money and securities. He rolls along the highway in a six-horse chariot, with six lackeys, each with double the peasant's income; his *maître d'hôtel* gets 2,000 crowns salary and steals 20,000; his mistress costs 80,000 crowns a year. "You pay of course half your income, 200,000 crowns, to the state?" asked the peasant. "You are joking, my friend," answered he, "I am no landed proprietor like you. The tax-

gatherer would be an imbecile to assess me; for everything I have comes ultimately from the land, and somebody has paid the tax already. To make me pay would be intolerable double taxation. Ta-ta, my friend; you just pay your single tax, enjoy in peace your clear income of twenty crowns; serve your country well, and come once in a while to take dinner with my lackey. Yes, yes, the single tax, it is a glorious thing." This little picture, perhaps, did more than all else to nullify the efforts of the Physiocrats.

We shall later discuss the effects of the modern single tax on the farmer, but the principle underlying Voltaire's thought is equally applicable here. On what grounds of morals or justice shall the landowner be singled out for taxation?

We have seen that the theory of natural rights is not adequate; we have learned that the principle of opportunity does not correctly portray the relations of the individual to the state. Even if the theory of unearned increment were true, it would not by any means justify the single tax on land values. In the first place, land values do not always or necessarily increase; and, secondly, there are a great many other values which increase mainly by the operation of forces which the owner of the property neither creates nor controls.

Land values do not always or necessarily increase. Thus, in the testimony given before the Rapid Transit Commission in the city of New York in March, 1895, one of the witnesses spoke of several long avenues being lined with the graves of property-owners. What did he mean? Simply that ten, or twenty, or thirty years before, certain individuals had invested in the land, in hope of a rise in value, just as people invest in bonds or stocks or other securities. Instead of values rising, however, they remained stationary or even decreased; while, in the meantime, the accumulated taxes and assessments upon this non-productive property completely ruined many of the investors. It is indeed true that in most growing cities land values in certain localities will increase; but it is equally true that there are always sections in such cities where, for obvious reasons, land values decrease. These facts are familiar to all observers in large cities. Moreover, in some European countries the rental value of the land, in whole sections, is less to-day, owing to transatlantic competition, than it was a few decades ago. The tax on land value would in such cases yield only a precarious revenue.

More important still is the fact that even though land values often increase, similar increase in value is not by any means confined to land. Let us ask anyone whose mind is not befogged by the mist of erroneous enthusiasms: Who are the rich men of the world to-day? How has by far the greater part of our huge individual fortunes been acquired? Let us study the way in which men have become millionaires, especially in the United States. The usual cause is some fortuitous conjuncture of events, some chance happening due to no one's labor, but to a turn in the wheel of fortune—call it speculation, call it luck, call it by any name we will. How have most of the fortunes in Wall Street been made? Who is responsible for the increased value of investments? Who can say that the successful manager of the ring, the corner, the pool and the trust has worked out his salvation through his own industry? Land speculation is only a part of the sum total. If it be claimed that the fortunate speculator deserves his fortune because of his sagacity and foresight, why deny these attributes, at least in part, to the landowner? It can, of course, not be denied that wealth has been acquired by thrift and industry; but it remains true that most of the very large fortunes that strike the common observer are due to these incalculable turns in the wheel of fortune, and that the so-called unearned increment of land values forms only a portion of these total gains.

Value is a social, not an individual phenomenon. If social environment gives a value to bare land, the same social environment, by increasing the demand for other commodities, may at least in part help to augment their value. It is indeed true that if we contrast land with concrete commodities that can be multiplied at will, the difference seems to be profound. Increased demand may lower, not increase, the price of the latter by reducing cost of production. But what the single-taxers forget is that property consists of, and income is derived from, not only concrete commodities, but services, relations and privileges of all kinds,[1] where increased demand, outstripping any corresponding decrease in the cost per unit of producing a greater supply, is primarily responsible for the increased value. A newspaper in a desert is worth nothing; a newspaper in a town is worth something; a newspaper in a city is worth still more. The newspaper is in part the product of labor, but the greater demand increases the value. A milk-route also is more profit-

[1] Seligman, *Principles of Economics*, 9th ed. (1921), §§ 84, 113.

able in a city than in a village. If it be said that land differs from all these in that it is a monopoly, the answer is irresistible that if there is any one thing which distinguishes the modern age, it is the development of economic monopolies of all kinds. So important, indeed, have these become that modern economic theory has been compelled to supplement the old doctrine of value which was based on the assumption of free competition by a newer and more comprehensive theory, especially applicable to all these modern forms of monopoly price. Many of these monopoly profits cannot be reached by a tax on land values.

On what possible theory of justice, then, shall we tax the man who has invested $100,000 in land which the next year appreciates fifty per cent; and, on the other hand, exempt the man who has invested $100,000 in the stock of the Sugar Trust, which the next year may also enhance fifty per cent? Why should the earnings invested in land be taxed and the earnings invested in any corporate security be wholly untaxed?

It might, indeed, be claimed that a railway stockholder will be affected by a tax on the land owned by the corporation: but it is difficult to see how a railway bondholder can be reached by any tax on land values except in so far as the ultimate security for his debt may be affected. As the bonded indebtedness of the railways to-day far exceeds their capital stock, it appears that, even in the case of these industries whose increasing values are largely due to the influence of the community, the majority of investors would scarcely be touched. In the great mass of industries, of which the Sugar Trust is an example, where the land owned by the corporation is of exceedingly small consequence as compared with its other assets, it is plain that a tax on land values would not reach even the stockholders or the owners proper. Almost every industry, moreover, is dependent for its increasing profits upon the development of the community, that is, upon the increasing demand for the product. Land rises in value because there are more people who want to occupy that land; the earnings of a city newspaper increase chiefly because there are more people who want news. In each case the increased returns are due primarily to social causes; and while a larger newspaper indeed costs more to produce, while more land does not, yet so far as actual profits are concerned, the distinction between them, for all practical purposes, is one only of degree, not of kind. To confiscate the capital invested in land with the chance of the land either falling or rising

in value, while exempting absolutely the capital invested in corporate or industrial securities, is but a travesty of justice. It will be impossible to convince the common people that so-called unearned increments are confined to land. As a matter of fact the "unearned increment" of land is only one instance of a far larger class.

So far as a man receives special opportunities from the community, which undoubtedly increase his ability to pay, they should be taken into account in framing any scheme of taxation. And since the rapid growth of modern towns brings into strong relief the appreciation of site values which are due primarily to the growth of the community itself, it is not only justifiable but eminently desirable that a part—and a large part—of the revenues should be raised from a tax on land values. But let us not single out one special opportunity, because it strikes the eyes of urban observers, while we neglect all the other opportunities which are equally, or almost equally, the result of social forces. While some kind of a tax on land values is a legitimate part of a tax system, the single tax on land values is unjust; first, because opportunity is not the only element that must be taken into account in framing a tax system; and, secondly, because, even though it were, revenues from land are by no means the only form of the results of special opportunity. The single tax is unjust because it is exclusive and unequal.

Even though the single tax, however, were theoretically just, it would not follow that it is desirable. Let us, therefore, come to the final part of our inquiry.

4. *Economic Defects*

These considerations which have often been overlooked, may be discussed from three points of view: first, the economic effect of the single tax on poor communities; second, the economic effect on farmers and the agricultural interests in general; third, the economic effect on rich communities.

In the first place, what would be the effect on poor communities?

In such cases the taxable property of the community consists principally of the often dilapidated farm houses erected on the land; of the tools, implements and beasts of burden used for tilling the land; and of the personal effects and money that belong to the farmers. Even making due allowance for the relative poverty of the community, it may be said that the great mass of

their possessions, therefore, consists of personalty. In so far as there is any real property at all, it is only to an exceedingly slight extent composed of land values. How then, it may be asked, can taxes be raised in a community like this? How can the roads be maintained, the school houses be kept up, and the other improvements be effected? Since land values are insignificant, a tax imposed on an insignificant basis must be insignificant. In fact it may be said that a total confiscation of the land values would not suffice to defray any considerable part of the necessary expenditures. If we take any of the assessors' reports in the less wealthy and not rapidly growing American states, it will be found that, contrary to the conditions of the rest of the country, the assessed personal property far exceeds in value the total assessed real estate. For instance, in 1890 personalty was to total realty in Montana as 58 to 55 millions of dollars, in Wyoming as 20 to 13 millions, in New Mexico as 28 to 15 millions. Compare these figures with the older sections, as New York or Pennsylvania, where the proportion was as 382 to 3,404 millions and 618 to 2,042 millions respectively.[1] In 1904, the date of the last available statistics, the proportions were about the same. Taxable personalty was to realty in Montana as 107 to 95 millions, in Wyoming as 28 to 18 millions, in New Mexico as 26 to 16 millions; but in New York as 686 to 7,051 millions and in Pennsylvania as 200 to 3,476 millions. The estimated true values were as follows: Montana, as 418 to 328 millions; Wyoming, as 197 to 133 millions; New Mexico, as 177 to 154 millions; New York as 5,617 to 9,151 millions; Pennsylvania, as 4,882 to 6,593 millions.[2] If we are to abolish not only the tax on personalty, but all that part of the tax on realty which is not drawn from land values, it can easily be seen how difficult it would be to carry on government in these sections.

What is true of poor communities as a whole applies also to the poorer sections of a rich community constituted largely or almost entirely of an agricultural population which is not rapidly increasing in numbers or wealth. The single-taxers themselves claim that land values amount to practically nothing in the farming districts. We shall see below the fallacy in this general contention; but so far as the community is a poor one

[1] These figures are taken from the census reports of 1890. See *Abstract of the Eleventh Census: 1890* (1894), p. 195.

[2] Census Report: *Wealth, Debt and Taxation*, 1907.

there is undoubted truth in the statement that land values are trivial. In the testimony taken before a recent tax commission of Massachusetts, one of the single-taxers who was testifying as to the situation in certain rural townships was asked the question: How will it be possible for this poor town, in which there is very little land value, to raise its taxes? The witness was compelled to reply that it would be impossible for the community to do so, and he suggested that the expenses of the poor communities should be defrayed in large part from the revenues of the rich communities.[1]

This proposal is not easy of accomplishment; for with the American theories of local government, it would be difficult to induce certain sections in the community to assume the burdens of other sections. We are all acquainted with the continual bickerings in our state taxation, due to the efforts of the richer counties to escape paying more than their proportion of the general state taxes; and we have seen the discontent aroused in 1894 by the attempt in the shape of the federal income tax to make certain wealthy sections of the country pay a disproportionate part of the revenue of the national government. Where these efforts have given rise to so much dissatisfaction, it is obviously improbable that the purely local expenses of any community will be defrayed by the efforts of other communities. While it is indeed true that the general state government has—and very properly—in recent years constructed highways and built hospitals, and while even according to our present system school taxes levied according to wealth are sometimes, in part at least, distributed according to population, this tendency, however desirable in itself, has well-defined limits. To a very large extent, at least, it will probably continue to be true that in purely local matters every county and town must stand on its own feet. But if the single tax is unable to defray even the local expenses of a poor community, not to speak of its share of general state or federal expenses, it is clearly beyond the realm of practical politics. In poor communities, unless rapidly increasing in population and resources, the single tax would be a somewhat precarious reliance.

Let us consider, next, what would be the effects of the single tax on farmers in general. One of the claims of the advocates

[1] *Cf. Hearings relating to Taxation*, 1893, pp. 185–188, and *Report of the Joint Special Committee on Taxation*, 1894, p. 38.

of the system is that it would relieve the farming population of the burden of taxes now weighing upon them. A careful consideration of the facts shows, however, that this claim is unfounded, and that, on the contrary, the result of the single tax would be to make the farmers pay more than they are paying to-day.

In only a few states is a distinction made in the assessments between land and improvements on land. Let us take, as a typical instance, Ohio county in West Virginia, in which the city of Wheeling is situated. In the auditor's report for 1892, we find the following figures: [1]—

	Ohio County	Entire State	Proportion of Ohio County Per cent
Value of buildings on lots,	$8,551,010	$22,840,511	
Value of buildings on lands,	671,795	14,371,855	
Total value of buildings,	$9,225,805	$37,212,366	25
Value of town lots without buildings,	4,409,152	14,453,321	
Value of land without buildings,	1,678,962	95,771,281	
Total value of all land without buildings,	$6,088,114	$110,224,502	5½
Total value of lands, lots and buildings,	15,313,919	147,685,972	10⅓
Value of personalty,	6,187,710	51,707,093	12
Total assessments,	21,501,629	198,959,920	10½
Population,	41,000	763,000	5¼

In other words, whereas Ohio county then paid ten and one-half per cent of all taxes, and would have paid about the same if real estate alone were taxed, had the single tax been introduced it would have paid only five and one-half per cent of the total taxes, or about one-half of what was actually the case. The corresponding figures for 1908 were 9.9 per cent on total valuation, 9.8 per cent on real estate alone, and 6.8 per cent on land values alone. If the large towns would pay so much less, of course the farming districts would have to pay so much more. The improvements in the towns are worth more than the value of the bare land; while in the country districts the reverse is true.

[1] These figures are subject to some qualification because of the inclusion of the value of oil leases in the personal property. But the corrections would probably not suffice to alter the conclusion.

As another example let us take California. In the comptroller's report for 1893, we find the following figures:—

County	Value of Real Estate (*i.e.* bare land)	Value of Improvements on Real Estate	Ratio of Land Values to Total Real Estate Per cent
Colusa,	$10,619,318	$1,283,265	89
Merced,	11,222,179	1,037,103	92
Tulare,	17,258,512	2,327,705	88
San Francisco,	193,872,615	82,584,775	70
Total state,	757,980,207	242,388,163	76

We thus see that while in the city of San Francisco improvements equalled thirty per cent of the total real estate value, in some of the country districts improvements were only ten or fifteen per cent of the total. Taking the state as a whole, land values equalled seventy-six per cent of all real estate, while in San Francisco land values were only seventy per cent of all real estate. To levy the single tax would, therefore, make San Francisco pay less, and some of the country counties far more, than at present.

Again, let us call attention to the report of the Commission on Valuation, made in 1892 to the Pennsylvania Tax Conference, which is probably the most careful attempt made up to that time to distinguish land values from improvements. We find the following figures:—

	Value of Land	Value of Improvements
Philadelphia county,	$357,007,936	$616,244,284
Purely agricultural land in Philadelphia county,	21,610,429	3,813,605
Entire state, all land,	1,881,334,522	1,754,525,949
Entire state, agricultural land,	725,485,439	245,494,072

The proportion of land values to total valuation of all property was in the county of Philadelphia, thirty-six per cent; in the agricultural counties of Sullivan and Greene, eighty-one per cent and seventy-five per cent, respectively; and in the whole state, fifty-two per cent. The Commission concludes: "As a rule, in agricultural counties the land values are the greatest, as would be expected; while in manufacturing counties and those having large cities, the value of the improvements is equal to that of the land, or greater."

Let us now choose some Western states. In the report of the auditor of Colorado for 1894 we find the following figures:—

Value of agricultural and grazing land, irrespective of improvements	$36,907,810
Value of improvements	7,492,022
Value of town and city land, irrespective of improvements	63,080,205
Value of improvements	34,788,941

In other words, in the towns improvements constituted about one-third of the total values; whereas in the country, improvements were only about one-sixth of the total.

As to Montana we find, in the report of the Board of Equalization for 1894, the following figures:—

Value of city and town lots	$29,362,754
Value of improvements on same	15,156,115
Value of land	17,493,680
Value of improvements on same	7,287,887

In Lewis and Clarke county, the home of the largest city in the state, the total value of all land was $11,397,860; that of improvements, $5,269,300. In some of the agricultural or grazing counties, however, the value of the land was far higher in proportion to the improvements; in Meagher county, for example, land was $1,821,385, while improvements were only $629,054. Most striking of all, in this very same county, in the case of agricultural property, the figures were: land $1,218,474, improvements $266,824; while in the town lots the figures were: bare land $602,911, improvements $362,375. In other words, not only are improvements proportionately less in the rural counties, but even in these rural counties by far the larger proportion of the improvements are found in the little towns, as compared with the farming or grazing land proper.

In the state of Washington, the State Board of Equalization agreed on the following figures for 1893:—

Value of land exclusive of improvements .	$ 87,527,472
Value of improvements	8,970,908
Value of city and town lots	101,889,377
Value of improvements	29,585,930

In Utah, Salt Lake county, the seat of the chief city, assessed, in 1893, real estate, exclusive of improvements, at $31,347,670;

improvements, at $9,483,141. In rural counties like Rich county and Cache county, the figures were, in the one case, realty $527,666, improvements $81,445; in the other case, realty $3,771,810, improvements $915,614. Here again, the more densely settled the township, the greater in proportion is the value of the improvements.

To choose more recent figures, the North Dakota state board of equalization fixed the valuation for 1910 as follows:

Land values	$146,654,672
Improvements	9,909,143
Town or city lots	11,066,982
Improvements	16,959,192

Almost equally remarkable figures are reported for Wyoming by the Commissioner of Taxation for 1909–1910:—

Land values	$40,029,518
Improvements	6,338,712
Town lots	12,836,541
Improvements	14,324,496

The same is true in the Eastern states. Thus in New Jersey, in 1911 in certain counties the land values were greater than the value of the improvements:—

County	Value of Land	Value of Improvements
Gloucester	10,474,115	8,574,078
Somerset	9,863,204	7,868,530
Salem	8,870,393	4,062,473

While in the cities the reverse was true.[1]

City	Value of Land	Value of Improvements
Camden	$18,610,635	$ 30,278,706
Newark	$134,764,835	150,144,175

In all these cases—and they might be multiplied—it is seen that the value of the improvements is, on the whole,

[1] These figures were fortunately not available when Mr. Shearman stated (*Natural Taxation*, ch. 12) that "in no large city are buildings worth more than 50% of all real estate."

greater in the urban than in the rural districts.[1] To many this will be a surprise, because they are apt to be blinded by the immediate facts about them. The single-tax advocate generally lives in the city, and sees before him a city lot, each foot of which will sell for hundreds or perhaps thousands of dollars. The town lot, he is apt to exclaim, is worth hundreds of times as much as a piece of land in the agricultural districts. This is perfectly true; but it proves nothing as to the comparative ability of their owners to pay taxes because it overlooks a point of the greatest importance. When we compare urban with agricultural land values, we do not compare foot with foot, but total units with total units. Thus, an acre of land in New York City may be worth a thousand times as much as an acre of land in the country; but it must be remembered that there are many thousand times as many acres in the country as there are acres in New York City. A lot in New York may be worth ten thousand dollars, but a farm of five hundred acres in the country may also be worth ten thousand dollars, exclusive of improvements. The farmer who has paid ten thousand dollars for his farm, and has then proceeded to improve and cultivate it, will not be satisfied, when the assessor taxes him and exempts all the business men and house-owners in the adjoining village, with the statement that the owner of a ten-thousand-dollar lot in New York City pays a hundred times as much per front foot. He will be apt to reply that it makes no difference to him whether the New Yorker's ten thousand dollars is taxed; but that he objects to his own ten thousand dollars being taxed, while his neighbors in the village, who are far richer than he, pay nothing at all. In short, while attention is directed to the fact that land values are undoubtedly less per acre in the country than in the city, it is forgotten that the number of acres in the country is so many times larger than the number of acres in the cities that the total land values in the

[1] The only official examination of this matter is found in the government report entitled *Taxation in Country and City: An Examination of the Distribution of Property Taxes as shown by Official Statistics of Assessed Valuation.* U. S. Dep'tm't of Agriculture, Division of Statistics, Misc. Series, 1900. This examination covered the District of Columbia and the sixteen states which assessed land values separately. The conclusion was that in a majority of the cases land values were proportionately greater in rural than in urban districts. The figures are printed and commented in Max West, "City and Country Taxes," in *Political Science Quarterly*, vol. 14 (1899), pp. 486–499.

country will form a substantial part of the whole. Moreover, we have seen that the value of improvements is relatively greater in the towns than in the country.[1] In the country the farmhouse is built for a few hundreds or thousands of dollars; in the city the fine stone mansion or steel skyscraper is erected at a cost of hundreds of thousands or millions of dollars.

If, therefore, all improvements were to be entirely exempted, the result of a tax on land values would be to make the farmers pay more than they do at present. It is not denied that as between the general property tax as actually administered and a tax on real estate only, the farmer would be benefited by the adoption of the latter. For personal property, as has been elsewhere explained,[2] is assessed chiefly in the agricultural communities. The remedy, however, consists not in taxing land values alone, but in striving to reach the owners of personal property by some other method than that of the general property tax. But even assuming that this reform cannot be effected, what the farmers would gain by the abolition of the personal property tax, they would lose and more than lose, as we have seen, by the total exemption of all improvements.[3] As long as the United States remains pre-eminently an agricultural community, it is not likely that the single tax will become a practical question.[4]

[1] The single-taxers claim that much of the present value of farm land—due to fencing, draining, *etc.*—should be classed as improvements. But, as we have pointed out above, it is quite impossible in practice to distinguish improvements on the land from improvements in the land. No attempt is ever made, in assessing land values, to differentiate between the two.

[2] *Supra*, p. 18.

[3] This conclusion is confirmed by Dr. West, after analyzing the official statistics, in the article cited on the previous page, in which he also states that "the exemption of intangible personalty alone would in a majority of cases relieve urban communities at the expense of rural districts; but that the exemption of both tangible and intangible personalty would benefit the rural districts in three-quarters of the commonwealths."

[4] In a pamphlet entitled *Peoples Power and Public Taxation*, written by A. D. Cridge and W. S. Uren, published by the Fels fund and distributed in 1910 to every voter in Oregon, some remarkable figures are presented as to the effect of the adoption of a land-value tax in lowering farmers' taxes. The figures are worthless because of the naïve assumption that the naked land value of tillable lands (those actually in cultivation) is no greater than that of the non-tillable lands. In other words, if a piece of good land is cleared, its naked land value, according to this view, would be no greater than that of an adjoining rocky hillside which is not put under cultivation because it would not be worth while. It is such arguments that are spread broadcast to the general public!

Thirdly, and finally, let us consider the economic effects of the single tax on rich urban communities.

It is contended by the single-taxers, with special reference to the advantages claimed as likely to accrue to the tenement-house population of the large cities, that the introduction of their system would bring about the social millennium. It is supposed that if we abolish the tax on improvements, that is, on houses, the vacant lots will be built over as if by magic, rents will fall, the wages of the workmen will rise, and a period of general prosperity will be ushered in.

It may be asked, in the first place, where all this additional capital which is to be invested in houses is coming from. There is no fund floating about in the air which can be brought to earth simply by the imposition of the single tax; the amounts to be laid out in houses must be taken from the capital now invested in some other form of productive enterprise. The amount of loanable capital in the money market at any one time is definitely fixed. Even deposits in banks are already invested, for the most part, in mortgages or in corporate securities; that is, they are already utilized for productive purposes. What is put into new houses will, therefore, simply be so much taken away from other productive employments.

It may be asked next, how are the rents of our tenement-house population so suddenly to fall? The theory that a tax on houses is shifted to the consumer or tenant is true enough, provided that the tax be exclusive—that is, provided that nothing be taxed except houses. If, on the contrary, the house tax is simply a part of a wider system of taxation; if other forms of property are assessed, like investments in land and in personal property; if a corporation tax is imposed to hit the investors in corporate securities; or if we have an income tax which is to reach general profits,—in all these cases the very conditions of the theory according to which a house tax is shifted disappear.[1] To the extent, then, that the house tax is not a single tax, the tendency for it to be shifted will be diminished. The only result, in this direction, of the single tax would be, as a matter of fact, that people would pay their rent to the state instead of to private individuals. We hear a great deal about the unoccupied lands held for speculative purposes in large cities; but it is a fact that south of Fourteenth Street in the city of New York—the home of the major part

[1] See *The Shifting and Incidence of Taxation* (4th ed.), pp. 292, 293.

of the tenement-house population—not seven-tenths of one per cent of the building lots lie idle, and of these some lots are occupied as coal yards, and some adjoining factories or large establishments are used for storage purposes.[1] How then would the single tax relieve the inhabitants of the slums? They will not go to the suburbs where there is an abundance of land, for the same reason that they do not go there now. Rent in the suburbs is at present relatively less than in the slums, which are nevertheless crowded. The average workman plainly prefers to be near his work, and to enjoy the social opportunities of contact with his fellow-workmen, evenings as well as daytime. Above all, without cheap and rapid transit, he cannot afford the expenditure of time and money, necessary for conveying the various members of his family to and from the suburbs. The single tax, however, would not alter conditions of transit. Even assuming, therefore, that there was some magic fund to cover the suburban lots with houses, the rents in the slums would not be affected to any appreciable degree.

Somewhat akin to this is the question of exempting improvements from the local tax on real estate, as a part of the whole scheme of taxation. Even here, however, it is scarcely open to doubt that the claims made by its defenders as a cure for urban congestion of population are greatly exaggerated.[2] In small towns where it is customary for the owner of the land also to own the buildings, it makes indeed, very little difference whether the tax is imposed in a lump sum on both land and buildings, or whether the same amount is paid by the owner on his land with the buildings exempted. The chief difference is to be found in the larger cities, where there is a variation in the proportion of the value of the structure to that of the land. Where the building value is sixty per cent of the total, as in the suburbs of a large city, compared with forty and thirty-five per cent in the crowded districts, it might seem that a remission of the tax on improvements would tend to foster the construction of buildings in the suburbs and thus to reduce rents all around and in this way lessen congestion. But entirely apart from the

[1] In 1911 there were south of Fourteenth street in New York 467 vacant lots, with a value of $9,844,910 out of a total number of 24,203 parcels of real estate with an assessed valuation of $1,319,866,666. See the *Report of the Commissioners of Taxes and Assessments* for 1911.

[2] See especially *Taxation of Land Values in American Cities, The Next Step in Exterminating Poverty*. By Benjamin C. Marsh, New York, 1911.

considerations adduced in the last paragraph as to the relative inelasticity of rents in the slums, it may be pointed out that if improvements are wholly exempt the tendency would obviously be for landowners in the crowded slums to erect still higher tenements, which would have to return only the interest on the lessened investment, and which would therefore again increase congestion. In point of fact, suitable transportation facilities, proper housing and building laws, and adequate credit conditions exert a far more important influence on congestion and house rents than does any system of exemption of improvements from taxation.

The exemption of improvements from the local real estate tax has been tried especially in Australasia and in Canada. In Australasia the results are inconclusive, and the real importance of the reform lies not so much in the exemption of improvements as in the substitution of capital values for rental values in the assessment of land. [1] In Canada several cities and provinces have in recent years exempted buildings in whole or in part, from the real estate tax.[2] The advantages of the system, however, have not been those advanced by its advocates. In Winnipeg and Vancouver, for instance, house rents have not fallen, but risen; and speculation at large, far from being abated, has increased enormously. This is, of course, due to the fact that taxation, even as a whole, is of incomparably less importance than the economic forces which make for the growth of the community. But it is quite idle to speculate upon what the result would have been if the improvements had been taxed; we are told that little difference can be noted between the Canadian towns where improvements are exempt and the American towns across the border, where they are taxed.[3] The true reason why there has been so little opposition to the exemption of improvements in Canada is that the tax rate, in the face of an enormous increase of land values which is naturally found in all rapidly growing communities, has been kept very low. Joined to this is the sentiment against absentee

[1] For a discussion of this *cf. infra*, p. 530.

[2] For a full and accurate statement of all the facts of the case see chap. viii. of *Provincial and Local Taxation in Canada*, by S. Vineberg, New York, 1912. This is no. 128 of the Columbia University *Series in History, Economics and Public Law*.

[3] See especially F. C. Wade, *The Single Tax Humbug in Vancouver*. Vancouver, 1912. Wade contends that the other Canadian "non-single-tax" cities have increased still faster than Vancouver.

ownership, which is often apt to be strong in any young community, as is evidenced by similar movements toward the exemption of improvements that are found in the early history of prosperous American states.[1] The situation in Canada is the same as that in Australasia.[2] As soon as the normal conditions of a long established community present themselves, with only a gradual and moderate increase of prosperity, but with the rapidly growing expenditure of a complicated economic life, the real problem will present itself, as it is, for instance, found in the cities of the Eastern United States.

So far as it is true that land in or near cities is held largely for speculative purposes, the difficulty can be met by the enforcement of now existing laws, and by the imposition of a special or a higher tax on unoccupied lands in or near the city. The tax laws of the American states everywhere instruct the officials to assess property at its true or selling value, but it is notorious that unimproved lots are, as a rule, considerably undervalued as compared with those on which improvements have been erected. If, then, we simply enforce the laws as they exist, it will be more difficult for anyone to hold land too long on speculation. If in addition we impose a special tax or a higher tax on unimproved city lots, it will be still more difficult to do so. It is thus evident that the desired end may be accomplished without invoking the aid of the single tax.

[1] In the territorial days of Iowa, for instance, improvements were exempted for a time in 1840, and a few years later an important discussion took place in which the disadvantages of the unearned increment accruing to non-settlers and especially to absentee speculators were fully set forth, with reflections on the dangers of land monopoly. As the country was built up, however, absentee ownership diminished in its relative importance and the demand for the exemption of improvements disappeared. *Cf.* J. E. Brindley, *History of Taxation in Iowa*, 1911, i., pp. 23–28, and the interesting editorials from contemporary newspapers, pp. 370–371.

Still further back, namely in the seventeenth century we find a similar movement although for somewhat different reasons. In 1652 Director Stuyvesant of New Amsterdam proposed a tax on unimproved lands only. The bill was drawn and would have passed but for the necessity of a larger revenue from more general sources, due to the war between Holland and England. See O'Callaghan, *Laws and Ordinances of New Netherlands, 1638–1674, sub anno.* Two years later it was proposed that vacant lots in New Amsterdam, Beverwyck and other towns, which had been granted for building purposes, should be sold at an official valuation "in case the present owners and proprietors either neglect or are disinclined to build on aforesaid vacant lots." *Ibid.*, p. 181.

[2] *Cf. infra*, chap. xvii, sec. vi.

Furthermore, so far as the idea of unearned increment is really applicable to urban real estate, the problem can be solved not only by extending the American system of special assessments which takes for public purposes, and precisely at the time of its creation, the increased value which may properly be said to be due to any positive action on the part of the community; but also by imposing an additional increment-value tax, which will take for the community a part of the increased value caused by the silent growth of the community itself.[1] By enforcing the tax laws as they exist to-day, by extending the law of special assessments to all the cases which are properly referable to the principle of benefits, by levying a special tax on unbuilt city lots and by adding to the existing code of taxation some form of increment-value land taxes, we shall in all probability do as much as is under existing conditions either practicable or equitable.

IV. *Conclusions*

We have studied the single tax from different points of view. It is undoubtedly true that the single-tax agitation has been of great value. It has in some countries served to direct attention to the abuses of a mediæval land system. It has in the United States helped to disclose the shortcomings of the antiquated general property tax. It has everywhere done yeoman's service in emphasizing the question of unjust privilege. But none the less we have found ourselves unable to accept its demands. We have seen that the single tax is defective fiscally, politically, morally and economically. We have learned, first, that it would be inelastic, and that it would intensify the inequalities resulting from unjust assessments; secondly, that although itself proposed chiefly from social considerations it would prevent the government from utilizing the taxing power for other social purposes, and that it would divorce the interests of the people from those of the government; thirdly, that it would offend against the canons of universality and equality of taxation, and that it would seriously exaggerate the difference between profits from land and profits from other sources; and finally, that it would be entirely inadequate in poor communities, that it would generally have an injurious influence on the farmer, and that even in the large urban centres it would ex-

[1] As to this *cf. infra*, pp. 491 *et seq.*, 508 *et seq.*

empt large sections of the population without bringing any substantial relief to the poorer classes.

This is clearly not the place to discuss the wider claim of the single-taxers, that the application of their scheme would introduce the social millennium. Even as a method of tax reform, however, the project is, as we have seen, a mistaken one. Our system of taxation is far from being ideal, or even comparatively just. But whatever be the much needed reform and however desirable may be the addition of a tax on land values to existing revenue systems, it is not probable that either the common people or the student will accept a scheme which is at bottom palpably unjust, which abandons one of the fundamental theories of modern taxation—that of relative ability or faculty—and which seeks to put the burdens of the many on the shoulders of the few.

NOTE TO 10TH ED. The Single Tax movement suffered a notable diminution during the second decade of this century. This is due primarily to the fiscal necessities of the Great War, but in part to the reaction which followed the attempts to exempt improvements from taxation in the Canadian localities. A bequest from an enthusiastic single taxer has, however, provided funds for keeping up a periodic, but unsuccessful, contest in some of the American states. The California discussion of 1917 is responsible for C. C. Plehn, *For and Against the Single Tax*, 1917. For an historical account of the movement see A. L. Young, *The History of the Single Tax Movement in the United States*, 1916, and the *Single Tax Year Book*, ed. by Joseph Dana Miller, New York, 1917. A more recent defender of the single tax is H. G. Brown, *Two Essays on the Taxation of Unearned Income*, Columbia, Mo., 1921, whose contentions are effectively riddled in an amusing article by W. I. King, "The Single-Tax Complex Analyzed," *Journal of Political Economy*, v. 32 (1924), p. 604.

For the German literature of the Single Tax see B. Eulenstein, *Nur eine einzige Steuer*, Berlin, 1894; R. Dollfus, *Uber die Idee der einzigen Steuer*, Basel, 1897; J. G. Kellermann, *Das Besitzsteuersystem die künftige, einzige direkte Steuerquelle aller Reichsstaaten*, Passau, 3d ed., 1889; A. Auersward, *Beiträge zur Lehre von der einzigen Steuer*, Greifswald, 1922. An early opponent of any form of single tax was H. Hoffmann, "Ueber staatswissenschaftliche Versuche den ganzen Bedarf für den öffentlichen Aufwand durch eine einzige einfache Steuer aufzubringen," Proceedings of the *Akademie der Wissenschaften*, June 22, 1843.

Recent discussion in Latin America has led to several books of which the most important are Teodoro Becu, *Impuestos al mayor valor de la propriedad immueble*, Buenos Aires, 1914; M. A. de T. Pinto, *El impuesto unico y la extención de impuesto a las mejoras*, Buenos Aires, n. d. (1924); and the Mexican, M. C. Rolland, *Salvemos la patria*, New York, n. d. (1916).

CHAPTER IV

DOUBLE TAXATION

Double taxation in the simplest sense denotes the taxation of the same person or the same thing twice over.[1] This is at once a very old and a very new phenomenon. It is very old so far as it is founded on mere extortion, on the caprice of government and on the desire to raise revenues without any regard to the relative burden on the taxpayer. All government was at first based on might. Although this was the original cause of the double taxation of one man and the exemption of his neighbor, it is in modern times entirely overshadowed by the second cause, which is essentially of recent growth. We live in an age of industrial complexity and differentiation. In former times property rights were simple, and the little capital that existed was largely owned by the producer. To-day not only does the same capitalist invest in different enterprises, not only is the producer often dependent for a part of his capital on sums that belong to others, but the old geographical unity has been dissolved, and there is no necessary connection between the residence

[1] *Cf.* F. Walker, *Double Taxation in the United States*, in the Columbia *Studies*, vol. v., no. 1 (1895); the articles by T. Sutro, in *Proceedings of the Second International Tax Conference*, 1909, p. 547; and C. Crocker, *Fourth Conference*, 1911, p. 264; and "Report of the Committee on Double Taxation" in the *Ninth Conference*, 1915, p. 358. For the earlier literature see A. L. Perry, *Extra-territorial Taxation*, Boston, 1875; G. G. Crocker, *An Exposition of the Double Taxation of Personal Property in Massachusetts*, Boston, 1885; and *The Injustice and Inexpediency of Double Taxation*, Boston, 1892; J. C. Ropes, *Double Taxation*, Cambridge, 1884; J. P. Quincy, *Double Taxation in Massachusetts*, Boston, 1889; R. H. Dana, *Double Taxation unjust and inexpedient*, Boston, 1892; and *Double Taxation in Massachusetts*, Boston (1895).

For the foreign literature see M. J. Brincour, *Des doubles impositions fiscales*, Louvain (1910); Lieppert, F., *Das internationale Finanzrecht*, Vienna, 1912; and G. Fasolis, *Le doppie imposizioni*, Città di Castello, 1914. *Cf.* also numerous articles by Lehr, von Bar and Worms, in the *Revue de droit international et de législation comparée* from 1889 to 1903; the committee report in *Annuaire de l'institut de droit international*, v. 16 (1897), p. 118; and the articles by Wittman and by Robertson in the 24th and 25th *Conference of the International Law Assoc.*, London, 1908 and 1909.

of the capitalist and the place where his capital is employed. A system of taxation, therefore, which may have been perfectly just under the older and simpler conditions, may now be entirely inadequate because of the failure of government to take account of these new complications in property rights. As a matter of fact, almost all existing double taxation in civilized nations is due to inattention to these modern industrial intricacies.

If we approach the subject of double taxation more closely, we are confronted by serious difficulties. There are almost as many kinds of duplicate taxation as there are kinds of taxes or of industrial relations. We find the term used with the utmost looseness, so that what may be in one state a very important species of double taxation may be quite insignificant in another. In the first state, then, the phrase "double taxation" always calls up a particular set of problems; while in the other state the same phrase will denote something entirely different. Let us therefore endeavor to give an analysis of the phenomena which, while not entering into the details of the problem, will explain the principle in all states.

There are two distinct categories of double taxation—that by competing jurisdictions or authorities, and that by the same jurisdiction or authority. The first is essentially geographical in character. It is partly due to the fact that modern wealth is more or less cosmopolitan. A man living in one state and owning property in another may be taxed on the same property by both states, because they compete with each other in claiming jurisdiction over that property. Not only is this true as between foreign countries, but it is equally true, and in fact of far greater importance, as between conflicting authorities in the same country. The separate commonwealths in a federal state, the separate counties in a commonwealth, the separate towns in a county—each and all of them may make conflicting claims on the same individual or on the same piece of property. Double taxation—or it may be triple or quadruple taxation—by competing jurisdictions is thus a product of the modern mobility of capital and labor; and with the growing importance of local taxation, the difficulties are multiplied.

It may happen, however, that a single authority—the same town, county, commonwealth or nation—is confronted by essentially similar difficulties as to property or persons within its jurisdiction. Thus a man buys a piece of land, and borrows

part of the purchase price from another man living in the same town. If the town taxes the value of the land, which in this case includes the value of the mortgage, and then taxes the mortgage, the question of double taxation immediately presents itself. So, again, if a man invests his property in the stock of a corporation doing business in the same place while the state taxes both the investor and the corporation, we are confronted by the same difficulty. In such cases the taxes are imposed by the same authority or jurisdiction. Let us discuss each class in turn.

I. *Double Taxation by the Same Authority*

The simplest case arises when a person is taxed on his property, income or profits, while an additional tax is imposed on the property, income or profits of the business in which he is a partner. This clearly is permissible only where a general tax on business is levied as an impersonal tax or a tax on the thing [the business] side by side with the personal tax on the individual as such.

The first important instance of double taxation arises when an attempt is made to tax property and also to tax income; or to tax either property or income, and also to levy a business or license tax. On this point there is much misconception. Many consider this to be wrong, because it is double taxation. As a matter of fact, however, if all are put upon the same plane, the simultaneous taxation of property and of income works no injustice. If all the members of the class are treated alike, it makes no difference whether there is one single high tax on property, or a low tax on property and another low tax on the profits of the property. In fact, the government would be perfectly justified in taxing the property, the income of the property and also the expenses or any other attribute of the property. All such duplicate or triplicate taxes are perfectly reasonable so long as they fall equally on all. Taken together, they amount simply to a high rate for a single tax on the property. Double taxation, therefore, is not always wrong; it is unjust only when one taxpayer is assessed twice while another in substantially the same class is assessed but once. It is the inequality of taxation that instinctively shocks us. But if all persons within the class are equally subjected to the burden, there can be no just complaint.

It may be objected that people are not treated alike when

they pay different taxes on the same income. Our opinion must depend, however, entirely on the attitude we take toward what is called "differentiation" of taxation. If we maintain that all incomes should be taxed alike, irrespective of source, the objection would be valid. But modern theory has formulated the demand for a distinction between earned and unearned incomes, or between incomes from labor and incomes from property. Even so conservative a writer as John Stuart Mill was an adherent to this principle, which is at present quite generally admitted. This "differentiation" may be secured in two ways. A lower rate may be levied on labor incomes than on property incomes, as in the present North Carolina or North Dakota income tax, and as in Great Britain, in Italy, in Holland and in some of the Australian states. But instead of making a difference in the rates, the same result may be reached by levying a uniform tax on all incomes and an additional tax on property, so that the income from property thus indirectly pays a higher rate. This was the case in Prussia and is still found in some of the Swiss cantons, where the property tax and the income tax are levied on the same property. In other words, property income is put into a different class from labor income. It is taxed twice—once on property and once on income—because the seeming inequality is considered to be really a higher equality. It is double taxation, but it is not unjust double taxation.

In some places the principle of differentiation has not yet been adopted. When the income tax is added to the property tax, the income from property already taxed is exempted, as in Massachusetts and in some of the Swiss cantons. Many difficulties have, however, arisen in the endeavor to distinguish these property incomes. Thus in Massachusetts the question presented itself whether the income from a business could be taxed, if the property invested in the business was already taxed. In a leading case this practice was upheld on the ground that business profits are the result not only of the capital invested, but of the industry and skill of the capitalist.[1] Although this is no doubt true, as a matter of fact the interpretation of the Massachusetts law was unjust because incomes derived solely

[1] Wilcox *vs.* Middlesex, 103 Mass. 544. *Cf.* the interesting discussion in J. A. Lane, *Address on Taxation with Special Reference to Taxation upon Income derived from Property subject to Taxation*, Boston Executive Business Association, 1891. *Cf.* also *Report of the Special Commission on Taxation*, Boston, 1891.

from land or from other investments pay only once, while incomes derived from business enterprise pay twice, once on the property invested and again on the income derived. It is this inequality of the tax which renders the system crude and inequitable. This has been recognized in practice, and the custom has arisen for the assessor to allow six per cent on the capital invested in the business as representing the income from capital, and to levy the income tax only on the surplus profits. In the Swiss cantons similar provision is made by law and applies to incomes from all property, the amount exempted being four to five per cent of the capital. These figures are, indeed, entirely arbitrary, although they represent an interesting attempt to avoid double taxation.[1]

If, however, we accept the principle of differentiation, this attempt is to a certain extent unnecessary. The higher taxation of income from property as compared with income from other sources is theoretically defensible, although the exact amount of increase cannot be fixed *a priori*. It is only when the additional rate exceeds this amount that we can really speak of unjust double taxation. Up to that point it may indeed be double taxation, but it is not necessarily unjust taxation. We may, then, conclude that to tax property and also the income from property is not of itself inequitable, provided that the income from all property is taxed. To single out a special class, as is done in Massachusetts, does indeed involve injustice. But if the tax applies to all property, the simultaneous taxation of property and income is not of itself reprehensible double taxation. Incomes from property should be taxed higher than incomes from labor.

The second important case of double taxation is connected with the question of indebtedness. Shall debts be deducted from assessments for the property tax, or the interest on indebtedness from assessments for the income tax? [2] Is it double taxation to tax the creditor on the debt, and the debtor on the whole property including the debt?

Put in this way the answer is plain. A man must be taxed upon what he has, not upon what he has not. What he owes to another is not really a part of his property. The one great reason why the countries of continental Europe are changing their

[1] For some additional considerations, see *infra*, chap. viii, sec. ii.

[2] The fullest study of this case is Heckel, *Die Einkommensteuer und die Schuldzinsen*, 1890.

system from taxation of product to taxation of income, is that under the former method, which disregards the personal position of the individual, no deduction is made for indebtedness; whereas by the income tax such deduction is made. For net income can mean only the surplus above all necessary outlays—including interest on debts—connected with the acquisition of the revenue. Every income tax, whether in Europe or in America, therefore permits interest on indebtedness to be deducted.

What is true of the income tax is equally true, in theory, of the property tax. But the practical limitations to the application of the theory in the case of the latter, and more especially in the tax on personalty, are very considerable. The unfortunate experience of the United States has already been discussed.

There is, however, one special phase of the question which is of widespread interest. In the case of a tax on land or on real estate, what should be done with the amount of the mortgage? The problem of double taxation arises, as in several of the American states, when the borrower or mortgagor is assessed on the full value of his land, and the lender or mortgagee is also taxed on the amount of the mortgage debt. If A, the owner of a $100,000 farm, borrows $50,000 from B, the state thus taxes $150,000, when there is really only $100,000 of property; and so far as B is able to shift his tax on A, the latter pays the taxes for both.[1] On the other hand, if the mortgagor is allowed to deduct the value of the mortgage, and if the mortgage debt is not taxed at all to the mortgagee, the state loses a legitimate revenue. It now taxes A on $50,000 and does not tax B at all, thus getting a revenue from $50,000, when there is really $100,000 of property. In the one case we have double; in the other, we have inadequate taxation.

What is the remedy? Several plans have been tried. According to the first the mortgagor is taxed on the full amount of the property, but the mortgagee is exempt. This method is based on the theory that the tax on the lender will be shifted at any event to the borrower, that as a result of the exemption of mortgages capitalists will lend more readily and at a lower rate, and that the benefits of exemption will accordingly be

[1] In 156 Pa. 488, the taxing of both land and mortgage was held not to be double taxation.

diffused throughout the community.[1] This plan is obviously the simplest and most effective method of avoiding double taxation. Several American states have now adopted this plan, with great satisfaction to all concerned. For under this scheme, in the case mentioned above, the state will still get the revenue on the entire $100,000 worth of property, and the mortgagor will not have to pay the double tax, once to the state and again in the shape of interest to the lender.

A second plan consists in exempting not the lender, but the borrower; not the credit of the mortgagee, but the liability of the mortgagor; that is, to tax the lender on the amount of the mortgage and the borrower on the value of the property minus the mortgage. In working out this scheme, however, several commonwealths, like California and Massachusetts, adopted a slight modification. According to the amended plan, the mortgagor can offset the amount of the mortgage debt. The mortgage, on the other hand, is taxable in the hands of the mortgagee, but it is treated as realty, not as personalty—that is, its *situs* does not follow the domicile of the mortgagee, but it is taxed in the locality where the mortgaged property lies. If the tax is paid by the mortgagor, he may recoup it from the mortgagee. In Massachusetts, indeed, this provision is practically void, because nearly all mortgages contain a clause requiring the mortgagor to pay taxes upon the mortgaged estate, and a further agreement to pay all taxes upon the debt in the event of the repeal of the law. The practical result, therefore, is virtually the same as if mortgages were exempt, and the borrower taxed on the total value of his land.[2] In California, where

[1] See Seligman, *The Shifting and Incidence of Taxation*, 4th ed. (1910), pp. 332–337.

[2] See the *Report of the Special Committee of the Boston Executive Business Association on Taxation*, 1889, p. 31. For an investigation of the question as to how far the rate of interest has been affected, see Thomas Hills, *Address on Taxation, delivered before the Boston Executive Business Association*, 1890, p. 20; and Nathan Matthews, Jr., "Double Taxation of Mortgaged Real Estate," in *Quarterly Journal of Economics*, iv. (1890), p. 339. *Cf.* also R. H. Dana, *Double Taxation in Massachusetts. Published under the auspices of the Massachusetts Anti-Double-Taxation League*, 1895, pp. 72–86. For earlier discussions of the subject see Benjamin A. Willis, *Remarks on the Bill providing for the Exemption of Mortgages on Real Estate from Taxation*, New York, 1873; John C. Ropes, *Taxation of Mortgaged Real Estate*, Boston, 1881; A. W. Beard, *Taxation of Mortgaged Property. Remarks before the Legislative Committee*, n. p. 1881; Henry Winn, *The Exemption of Money Lenders from Taxation: its Effect upon the Interest Rate*, Turners Falls,

the plan was incorporated into the constitution of 1879, all such agreements between mortgagor and mortgagee were void. This continued until 1907 when, after an amendment to the constitution in 1906, a law was passed permitting separate contracts. Legal enactments, however, cannot prevent the operation of economic law. As a matter of fact, the interest rate on mortgages rose as a consequence of the law, and it has even been claimed with some degree of truth that interest rose by a slight amount over and above the tax, to compensate the lender for trouble and risk.[1] By the end of the nineties this was beginning to be recognized, and during the next decade the conviction of the futility of the old scheme became so widespread that in 1910 the constitution was again amended so as to provide for the complete exemption of mortgages. In the meantime, however, the Massachusetts or California system had been introduced in 1903 in Wisconsin, leading there also to practical exemption.[2]

In addition to these methods of attempting to avoid double taxation we find some alternative and halfway schemes. Several states which recognize the inevitable shifting of a tax on mortgages to the borrower or, on the other hand, the practical impossibility of the discovery of mortgages by the assessors, are nevertheless not ready to abandon all revenue from this source. A few of these states try to solve the problem by levying a special tax on mortgages, but at such a low rate that there is

1883; and the same author's *Mortgage Exemption and Taxation of Real Estate only*, Boston, 1889.

[1] See C. C. Plehn, "The Taxation of Mortgages in California," in *The Yale Review*, viii. (1899), pp. 31–67. For later studies on the question of the incidence of the tax on mortgages see *Mortgage Taxation and the Bostwick Bills.* Prepared by the New York Tax Reform Association, New York, 1904; *Mortgage Taxation and Interest Rates*, New York, 1906, a study made by the New York Tax Reform Association; T. B. Adams, "Mortgage Taxation in Wisconsin," in the *Quarterly Journal of Economics*, xxii. (1907), pp. 1–27; and R. A. Campbell, *Mortgage Taxation*, Madison, 1908.

[2] The same system at one time existed in Michigan, Missouri and Oregon. The Missouri constitutional amendment of 1900 was declared by the state court to be opposed to the federal constitution in Russell *vs.* Croy, 164 Mo. 69, on the ground that corporate mortgages were not treated in the same way as those of individuals. In Oregon the law of 1882 was declared unconstitutional in 1884 for much the same reason, but the defect was removed by an amendment of 1885. In 1893, however, the law was repealed. The Michigan law was also repealed in 1893, and mortgages were again taxable as personal property until 1911 when the mortgage-recording law was enacted.

less inducement to conceal them. A few others attempt to solve the problem by levying a small tax on the mortgage when it is recorded, and thereafter exempting it.[1] The first method involves practical exemption from the beginning, the latter complete exemption after the first year. Thus the tendency may be said to be everywhere in the direction of exemption as the best means of avoiding double taxation.[2]

In the above discussion we have treated primarily of individual indebtedness. The same question often arises in connection with corporate debts, especially in the shape of mortgage bonds. It has usually been overlooked, however, that there is a distinction between individual and corporate property or income. In the case of individuals, to tax both the property and the amount of the mortgage debt is theoretically unsound, because the individual's true taxable property consists in his surplus above indebtedness. The capital stock of a corporation, however, represents, in many cases, only a portion of the property, while the remainder is represented by the bonded indebtedness. In the United States, for example, it is well known that railroads are built mainly on the proceeds of mortgage bonds. To exempt the mortgage debt in the case of these corporations would thus be inequitable; for only by taxing both capital stock and mortgage debt can the state reach the true faculty of the corporation. In the case of individuals, indebtedness diminishes the capacity to pay taxes; in the case of corporations, indebted-

[1] As to this see C. F. Robinson, "The Mortgage Recording Tax" in the *Political Science Quarterly*, vol. xxv (1910), p. 609.

[2] At present (1921) only eleven of the American states still tax both mortgagor and mortgagee; ten (California, Idaho, Louisiana, Maine, Maryland, New Jersey, Oregon, Utah, Washington and Wyoming) exempt mortgages completely; four exempt mortgages not exceeding a certain rate (New Hampshire and Vermont, 5%; Mississippi, 6%; and North Carolina, 5½%, if not over $3,000) within the state; one (Indiana) exempts mortgaged land to the extent of $700, provided that this does not exceed one-half of the value of the real estate, but the mortgage credit is then assessed to the mortgagee at his residence; seven (Colorado, Connecticut, Massachusetts, Nebraska, Nevada, New Jersey and New Mexico) deduct the mortgage from the value of the land, but permit the mortgagor to assume the tax, the mortgage being treated as an interest in the real estate; three (Iowa, Pennsylvania and Rhode Island) tax mortgages at a special low rate; and eleven (Alabama, Kentucky, Michigan, Minnesota, Missouri, New York, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee and Virginia) tax mortgages at a low rate when they are recorded, through the mortgage-recording tax. *Cf.* R. A. Campbell, *Mortgage Taxation Department*, Madison, 1908; and E. L. McDonald, *Taxation of Mortgages in Kentucky* (with a table), Frankfort, 1916.

ness often augments that capacity because the so-called debt is in reality an integral and constituent part of the capital.

Strictly speaking, the proper distinction is not between corporate and individual credit, but between production and consumption credit. In the case of individuals, money borrowed for purposes of consumption or to meet pressing emergencies certainly comes under the above rule that indebtedness is to be regarded as a burden. When, however, money is borrowed in order to enlarge the business, the credit takes the place of capital and may enable the borrower to make larger profits. The income of the borrower therefore is really increased by the surplus of the additional net profits, due to the loan, over and above the amount of the interest on the loan. In an income tax this is automatically provided for, since the additional profits figure on the one side, and the interest charge on the other side, of the income account. Where the tax is levied on property, however, no allowance is made. Strictly speaking, only so much of the borrowed money ought to be assessed to the borrower as represents the capitalization of the surplus profits. Practically, however, this is impossible to ascertain, and we are therefore justified in demanding an exemption of debts from the property tax.

On the other hand, in the case of corporations, while debts are sometimes contracted to meet pressing exigencies, and may thus in a way be considered a kind of consumption credit, mortgage bonds at least are almost exclusively issued in order to provide capital. Economically, the corporate capital consists of the bonds and the stock. In England, as is well known, there are even no railroad bonds at all, but simply debenture stock. It is therefore quite fitting that the interest on corporate bonds should not be deductible in case of the income tax, nor the mortgage bonds themselves in case of the property tax. It is the correct recognition of this fact that has led to the introduction of the tax on corporate loans in many states, American and foreign.[1]

We come now to the third case of double taxation, which in the modern days of corporate industry has assumed much

[1] The great defect in the otherwise admirable study of Heckel, mentioned above, is the failure to distinguish between corporations and natural persons. He is indeed forced to the practical conclusion that corporations must be liable for the tax on mortgage debts, but his arguments are not convincing; *cf.* p. 182 of his work.

importance,—that of the double taxation of a corporation and of the investor in corporate securities. If we tax the corporation, shall we also tax the individual stockholder or bondholder?

The great divergence of practice in America, as well as abroad, will be discussed in another chapter; [1] but the economic theory is simple. If the tax—whether on income or on property—is general, and applies to all classes of corporations and to other non-corporate investments as well, it is manifestly double taxation to assess the security holder as well as the corporation. The tax on the corporation diminishes his income from the corporate security; an additional tax on the security would involve double taxation of the same income or property. But if the tax is a special or exclusive tax instead of being a general tax, the matter is different. In that case the general doctrine of capitalization of taxation will apply.[2] If only one class of corporations is taxed, the purchaser of these corporate securities will escape taxation, because the amount of the tax is discounted in the depreciation of the security. For example, let us suppose that a corporation previously untaxed has been paying five per cent dividends on its stock quoted at par. If a special tax of ten per cent be imposed on these dividends, the stockholders will get only four and a half per cent. But since by the supposition other classes of corporations, or at all events other non-corporate investments, are not taxed, the price of the stock will fall to ninety. People who can get five per cent on their capital will not ordinarily consent to take four and a half per cent. The original holders of the stock will indeed lose, but the new purchasers will not be affected, because the tax is capitalized and leads to a depreciation of the capital value of the stock. A dividend of four and a half dollars on stock costing ninety is as good as one of five dollars on stock costing a hundred. A tax levied only on corporate profits, or only on some special classes of corporations, does not affect anyone except those who become stockholders before the imposition of the tax. To tax the new purchaser on his security would not in such a case involve unjust double taxation.[3]

[1] *Infra*, chap. viii, sec. v.

[2] See Seligman, *The Shifting and Incidence of Taxation* (3d ed.), pp. 221–226.

[3] This and the following point is not considered at all either by Professor Wagner who is opposed to such double taxation of corporations, "Direkte Steuern" in Schönberg's *Handbuch der Politischen Oekonomie*, III. 1, 4th

There is one other condition under which the simultaneous taxation of the corporation and the security holder is not unjust. In the case of a stockholder, we have seen that if the tax is general it is unjust to tax both the corporation and the stockholder. In the case of a bondholder this would also ordinarily be true when the income tax on the corporation is, for instance, deducted from the interest of the bondholder as well as from the dividends of the stockholder. In some cases, however, it happens that the corporation is willing to assume the tax as a whole, and to count the tax among its fixed charges, declaring the coupons free from tax. In such a case it is really the stockholders who pay; for the interest on the bonds is fixed, and what is not deducted from the interest must be paid out of the surplus earnings which would otherwise ultimately go to the stockholders. The bondholders are not reached at all by such a tax, except in the very indirect way that they may be exposed to an ultimate diminution in the security of their lien. But the tax as such does not strike them at all; their property or income in the corporate bonds goes scot-free. An additional tax upon the bondholder would thus really not involve any injustice to them. Here, as well as in the preceding case, a study of the real incidence of the tax becomes important. What is apparently double taxation may turn out not to be such.

We may, therefore, sum up by saying that in so far as the tax is general, it is manifestly unjust to tax both corporation and security holder; but that when the tax is partial or when the corporation assumes the tax as a whole, the additional taxation of stockholder or of bondholder is not necessarily either double taxation or inequitable taxation.

There remains the fourth and final form of double taxation by the same jurisdiction, which has given rise to considerable difficulty. This applies especially to corporations. The question here is: Is it permissible to tax the corporation on its property and again on its capital stock?

The answer from the economic standpoint is simple. While the exact relations between capital stock and property are discussed more fully below,[1] it is clear, for the purposes of this

ed., p. 428; or by Professor Schaeffle, who is in favor of such double taxation (*Die Steuern*, vol. ii (1895), p. 24).

[1] *Infra*, chap. viii, sec. iii.

argument, that corporate property is at all events one of the elements that contribute to the value of the capital stock. If this be true, to tax the corporation on its property and then to levy an additional tax on its stock, is *pro tanto* duplicate taxation of an unjust character. If other persons are taxed only once on property, corporations should not be taxed again on what is at all events a part of their property.

This concludes the discussion of the important cases of double taxation arising from the actions of the same tax jurisdiction. Equally important are the cases due to the conflicts of jurisdiction between independent taxing authorities. These we now proceed to take up.

II. *Double Taxation by Competing Authorities*

The problems included under this head are essentially of modern growth. Until very recently they have received little attention, for three reasons. In the first place, the international relations of commerce and industry were comparatively unimportant; and even within the same state business methods and business investments were far more localized and less complicated. Secondly, the stranger in primitive society was originally an enemy. The survival of this idea in the conception that the foreigner, as such, is an especially desirable subject of taxation has only slowly given way to the broader conceptions of the modern age. Thirdly and chiefly, in former times but little attention was given to the question of justice in taxation. Even when the general problem was considered, the details of double taxation were regarded as insignificant. But nowadays the question is forging to the front.

It need not be pointed out that amid the complexities of modern industrial life equality of taxation cannot be attained without a careful consideration of these problems. To-day a man may live in one state, may own property in a second and may carry on business in a third. He may die in one place and leave all his property in another. He may spend all his income in one town and may derive that income from property or business in another town. He may carry on business in several states, or if he has invested in corporate securities, the corporation may be the creature of another state and may be situated or do business in a third. All these cases may affect foreign states or separate commonwealths of the same federal state, or

separate cities or counties of the same commonwealth. The possible entanglements are well-nigh innumerable.[1]

The question thus arises: Where shall a man be taxed? Whatever principle we lay down, it is plain that, if every state or every tax authority followed the same principle, it would be easy to avoid double taxation. The complications arise from the fact that one state follows one principle, and that another state follows an opposite or conflicting principle. Let us discuss the different principles that have actually been employed.

The oldest principle is that of citizenship or political allegiance. Originally only the citizen of the state or the burgess of the town had any obligation to the government under which he lived. But it soon happened that commercial relations developed, until in modern times the actual population of any state or community is by no means limited to citizens. To tax only the citizen and to exempt the stranger, whether the stranger be from another state or only from another city, would plainly be inadmissible. Political allegiance in this sense is nowhere to-day made the basis of taxation. Yet when political allegiance involves a positive rather than a negative attitude, it is still followed, at all events in international relations. While the stranger is not exempted, the citizen living abroad is frequently held responsible to his country. Political fealty cannot be so easily abandoned; political rights involve political duties. Among them is certainly the duty to pay taxes.

In modern times, however, the force of political allegiance has been considerably weakened. The political ties of a non-resident to the mother country may often be merely nominal. His life may be spent abroad and his real interests may be indissolubly bound up with his new home, while his loyalty to the old country may have almost completely disappeared.

[1] The question has naturally attracted some attention in federal states. We find little discussion of the problems in French or English books on finance. It is only lately that the matter has been seriously discussed in Germany and Switzerland. See especially Schanz, "Die Ort der Besteuerung," in *Finanz Archiv*, vol. ix (1892); and G. Antoni, "Die Steuersubjekte im Zusammenhalte mit der Durchführung der Allgemeinheit der Besteuerung," in *Finanz Archiv*, vol. v (1888), p. 916. A more recent work is J. Fischer, *Die Doppelbesteuerung in Staat und Gemeinde*, Berlin, 1909. *Cf.* also H. Kramer, *Die Einkommen- und Vermögenbesteuerung der Ausländer und Forensen*, Berlin, 1909; and Schneider, "Einkommensbesteuerung der über mehrere Staaten sich erstreckenden Gewerbetriebe mit besonderer Berücksichtigung der württembergischen Rechtssprechung," in *Finanz Archiv*, v. 28 (1911), p. 615.

In many cases, indeed, the new home will also become the place of a new political allegiance. But it is well known that in some countries the political bond cannot be dissolved even by permanent emigration; while it frequently happens that the immigrant has no desire to ally himself politically with what is socially and commercially his real home. In the modern age of the international migration of persons as well as of capital, political allegiance no longer forms an adequate test of individual fiscal obligation. It is fast breaking down in practice, and it is clearly insufficient in theory.

The second principle that may be followed is that of mere temporary residence; every one who happens to be in the town or state may be taxable there. This, however, is also inadequate. If a traveller chances to spend a week in a town just when the tax collector comes around, there is no good reason why he should be assessed on his whole property by this particular town: the relations between him and the government are too slight. Moreover, as he goes from place to place, he may be taxable in each place or in none. Temporary residence is plainly inadmissible as a test.

The third principle is that of domicile or permanent residence. This is a far more defensible basis, and it has many arguments in its favor. Those who are permanently resident in a place ought undoubtedly to contribute to its expenses. But the principle is not perfectly satisfactory. For, in the first place, a large part of the property in the town may be owned by outsiders: if the government were to depend only on the permanent residents, it would lose a portion of its rightful dues. In the second place, most of the revenues of the resident population may be derived from outside sources, as from business conducted in other states. In this case, the home government would be gaining at the expense of its neighbor. Thirdly, property owners like the absentee landlords of Ireland or the absentee stockholders of the railways in the western states of America cannot be declared devoid of all obligation to the place whence their profits are derived. Domicile, therefore, cannot be the exclusive consideration.

The fourth principle is that of the location of the property, or origin of the income. This again is undoubtedly legitimate to a certain extent. For a man who owns property has always been considered to have such close relations with the government of the place where his property is situated, as to be under

obligation to support it. But for reasons just the reverse of those mentioned in the preceding case, the location or the origin clearly cannot be the only test. Permanent residents of means owe some duty to the place where they live, even if their property is situated elsewhere. A New Yorker who has invested even his whole property abroad cannot be said to be entirely without any duty to support the New York or American government.

We see then that each of the last three principles—temporary residence, domicile and location of property—has a certain, but none a complete justification. There is, however, one final principle, toward which all modern governments are tending, which reconciles the three preceding tests. This is the principle of *economic interest* or *economic allegiance*, as against the antiquated doctrine of political allegiance. Every man may be taxed by competing authorities according to his economic interests under each authority. The ideal solution is that the individual's whole faculty should be taxed; but that it should be taxed only once, and that it should be divided among the tax districts according to his relative interests in each. The individual has certain economic interests in the place in which he happens to live, in the place of his domicile, and in the place or places where his property is situated or from which his income is derived. If he makes money in one place, he often spends it in another.

It has been pointed out elsewhere that the conception of faculty in taxation involves two considerations,—those connected with acquisition or production, and those connected with outlay or consumption.[1] In apportioning the total fiscal obligation of the individual it is therefore necessary to ascertain from what place or places his earnings are derived, and then to observe in what place or places they are expended. Only in this way can his real economic interests be located.

From this point of view the solution of the problem would be easy. Let the state or states from which the earnings are received divide among themselves the taxes on production, that is, the taxes levied according to property or income or business or any other measure of productive capacity: let the state where the individual lives and where the earnings are spent levy taxes on consumption, whether direct or indirect.

[1] See Seligman, *Progressive Taxation in Theory and Practice*, 2d ed. (1908), pp. 290–294.

This plan, however, involves one serious difficulty. Expenditure, for obvious reasons, is no longer considered so satisfactory a basis of taxation as revenue. And although taxes on consumption are still largely employed and are defensible for the central authorities, their use for local or commonwealth purposes tends everywhere to be restricted to narrow limits. Where taxes on consumption are abandoned, it becomes necessary to devise some compromise in apportioning the taxes on production. Some writers have suggested that three-quarters of the tax on property or business or earnings should go to the state of domicile, while others have proposed an equal division. It may be conceded that the exact division is necessarily arbitrary; but even an arbitrary division is better than no division at all. Whatever figures we adopt, it is none the less clear that the principle of *economic interest* will help us out of many a difficulty.

In international relations we have scarcely begun to apply the doctrine; in fact, we still cling in part to the principle of political allegiance. The result is much unjust double taxation.[1] In internal relations, as in the federal states of America, Germany and Switzerland, more progress has been made. In the United States, as to a large extent everywhere else, the rule of *situs* has been applied to real estate. This is taxed where it is situated. But in the case of personalty or business most countries waver between the doctrines of *situs* and of domicile. In America, for example, while most of the states tax personal property actually located within their bounds,[2] we find in many places the legal principle, which had its origin in entirely different reasons, that personalty follows the owner—*mobilia personam sequuntur.*[3] Accordingly if the owner is a nonresident, his personal property may be taxed twice—once by the state where it is located, and again by the state of his domicile.

[1] *Cf.* from the point of view of international law various essays by E. Lehr, "Les doubles impositions en droit international," in *Journal Clunet*, 1901, p. 722; "Les bases de l'impôt en droit international," in *Revue de droit international*, 1897, p. 428; "Les Bases légitimes des impôts en droit international," *ibid.*, 1903, p. 547. *Cf.* also L. von Bar, "Observations sur les principes du droit international concernant les impôts, notamment les doubles impositions," *ibid.*, 1900, p. 435.

[2] That this is permissible is recognized in Coe *vs.* Errol, 116 U. S. 517.

[3] Or, as it is sometimes put, *mobilia inhaerent ossibus domini*. *Cf.* in general, Story, *Conflict of Laws*, §§ 362, 383, 550. The original use made of this principle in America may be seen in Catlin *vs.* Hall, 21 Vt. 152.

In the United States several commonwealths have indeed provided by statute for the exemption of a resident's personalty, if located and taxed in another state. Such is now the law in Alabama, California, Connecticut, Indiana, Louisiana, Maine, Massachusetts, Missouri, New Jersey, Ohio, Rhode Island, South Carolina, Vermont and West Virginia.[1] The same rule has been extended by judicial interpretation to Illinois, Kansas, Missouri, New York, North Carolina and Ohio.[2] In other commonwealths the rule is applied only in part. Thus in Arkansas, South Carolina and Virginia a similar exemption is made for all personalty except in so far as money, credits or investments in business are concerned.[3] In Delaware only so much of the personalty is exempt as consists of non-productive securities of other commonwealths.[4] Finally, in Michigan all the personalty of a resident is taxable except that which is invested in another commonwealth.[5] But in most of the commonwealths the legal fiction still prevails, and the individual is taxed on all his personalty irrespective of its location. The obvious result is double taxation of a nature which cannot possibly be justified.

[1] Ala. Code (1896), § 3911; Cal. Polit. Code (1903), § 3607; Conn. Gen. Stat. (1902), § 2321 *et seq.* (applies to property actually invested in merchandising or manufacturing); Ind. Annot. Stat. (1894), § 8410; La. Act July 9, 1890, no. 106, § 1; Mass. Laws. 1918, c. 129; Me. Rev. Stat. (1904), ch. 9, § 13–II; Mo. Rev. Stat. (1889), §§ 7503, 7508, 7531; N. J. Rev. Stat. (1877), p. 1151; O. Rev. Stat. (1892), § 2735; R. I. Pub. Stat., chap. 42, § 9 (applies only to machinery, machine tools, stock in trade, merchandise, lumber, coal and stock in livery stables); S. C. Code (1902), § 268; Vt. Stat. (1894), § 362–IV; W. Va. Code, chap. 29, § 48.

[2] Mills *vs.* Thornton, 26 Ill. 300 (1861); Fisher *vs.* Commissioners of Rush County, 19 Kan. 414; State *vs.* St. Louis County, 47 Mo. 594 (1871); State *ex rel.* Dunnica *vs.* County Court, 69 Mo. 454 (1879); Valle *vs.* Ziegler, 84 Mo. 214 (1882); People *ex rel.* Hoyt *vs.* Commissioners, 23 N. Y. 224 (1861), which decided that shares of foreign corporations are exempt from local taxation in New York because they have no *situs* in the state; People *ex rel.* Trowbridge *vs.* Commissioners, 4 Hun, 595 (1875); 2 Jones Eq. Rep. 53, where the principle *mobilia personam sequuntur* is declared to be "a fiction which has no application to questions of revenue"; Carrier *vs.* Gordon, 21 Ohio, 605 (1853). The Supreme Court has now recognized the principle that tangible personality if permanently located is taxable where located, and not elsewhere. Union Transit Co. *vs.* Ky., 199 U. S. 194: Southern Pacific Co. *vs.* Ky., 222 U. S. 63. For a comprehensive survey of the law see "Analysis of Cases relating to Situs" by E. F. Trabue in *Proceedings of the National Tax Association, Eighth Conference*, 1915, p. 242.

[3] Ark., Mansfield's Digest, sec. 5048; S. C. Gen. Stat., chap. 11, sec. 149; Va. Code, sec. 492.

[4] Del. Laws 1879, chap. 2.

[5] Mich. Laws 1885, no. 153, sec. 2.

According to the doctrine of economic interest, the solution is plain. A large part of the tax should go to the place where the property lies or whence the earnings are derived; a smaller share to the domicile of the owner. But this presupposes uniform action on the part of the conflicting authorities. As long as no interstate or intercommunal agreements are made, the simplest plan would be for the state of location to tax the tangible property, and the state of residence to tax the intangible property or income therefrom.

This conclusion, however, is complicated by several considerations. In the first place, the intangible property may consist of corporate securities, while the corporation may already be taxed in the state where it is situated; secondly, the intangible property may consist of a mortgage on real estate abroad, which in that state is treated as realty and already taxed; and finally, the American experience with the taxation of intangible personalty in general is very sad. For practical purposes, therefore, the conclusion would be: Tax only realty and tangible personalty, and tax this in the state of location. When the era of interstate agreements is finally reached, it will be feasible to attempt the more ideal plan of taxing the entire property or income, dividing the proceeds among the states of location and domicile according to a pre-established proportion, and in harmony with the doctrine of economic interest. In the interval it may be possible to reach intangible personalty through some form of national taxation, the general government then to apportion the proceeds to the states.

In Germany and Switzerland the situation is much simpler than in the United States because of the existence of federal regulation upon the entire subject. In Germany the federal regulation dates from 1870, and was further developed by a law of 1909.[1] A German citizen is now subject to direct taxes only in the state of his domicile or, where he has no domicile, in the state of his residence. Real estate and so-called fixed industry (*stehende Gewerbe*) can be taxed only in the state where the real estate or place of business is situated. If there

[1] *Cf.* Th. Clauss, "Das Reichsgesetz vom 13 Mai, 1870 wegen Beseitigung der Doppelbesteuerung unter vergleichender Berücksichtigung des Schweizer Bundesrechts erläutert," in *Finanz Archiv*, vol. v. (1888), p. 138 *et seq.*; "Deutsches Doppelsteuergesetz vom 22 Marz, 1909," *ibidem*, vol. xxvi. (1909), p. 809 *et seq.*; R. Blochmann, "Das Reichsgesetz wegen Beseitigung der Doppelbesteuerung vom 13 Mai, 1870 erläutert," in *Annalen des Deutschen Reichs*, 1887, nos. 7–10.

are several such places of business, the tax is divided among the various states according to a fixed proportion. If anyone is assessed in one state for a direct tax when he has paid a similar tax in another state for the same period, he has a right to reimbursement. The German law, however, is not complete in that it does not regulate the interlocal taxation. In the matter of local taxation it was thought best to leave the adjustment of conflicts to inter-state agreements, and of these not a few have been consummated.[1]

In Switzerland, on the other hand, the federal law applies to local as well as to state taxation. It was not until 1874 that the constitution empowered the federal government to prevent double taxation. After that time the federal council rendered a number of decisions most of which were summed up in the law of 1885.[2] The principles enforced are the same as in Germany, but are carried out in further detail and with greater effectiveness. The law applies also to inheritance taxes, which accrue in the case of real estate to the canton where it is situated, and in the case of personalty to the canton where the deceased was domiciled.

It will be well now to take up in turn the most important cases of double taxation by different jurisdictions. As the problems apply to interstate or inter-municipal complications as well as to difficulties between foreign countries, the word *alien* must be understood to include persons from another town or commonwealth as well as from a foreign country. And since the questions are precisely the same when applied to corporate business as when applied to individuals or individual business, the term *citizen* must be understood to mean legal as well as natural persons. Let us proceed to discuss the cases in order.

[1] *Cf.* Dr. Strutz, "Die Gemeindebesteuerung des Einkommens aus ausländischem Grundbesitz und Gewerbebetrieb in Deutschland," in *Verwaltungsarchiv*, vol. iv. (1896), p. 209; and Brincour, *op. cit.*, p. 10.

[2] *Cf.* the two works by E. Zürcher and F. Schreiber, each entitled, *Kritische Darstellung der bundesrechtlichen Praxis betreffend das Verbot der Doppelbesteuerung und Vorschläge zur Regelung dieser Frage*, and each published in 1882; B. Van Muyden, *Exposé critique de la jurisprudence fédérale en matiére de double imposition suivi des propositions en vue de réglement de cette question par une loi fédérale, 1882;* P. Speiser, *Das Verbot der Doppelbesteuerung* (1887); C. A. Brodtbeck, *Unser Bundesrecht in Doppelbesteuerungssachen* (1898); P. Steiger, "Ueber die Grundzüge eines Bundesgesetzes betreffend das Verbot der Doppelbesteuerung," in *Zeitschrift füt Schweizerisches Recht*, vol. 43 (1902).

1. *Shall a resident citizen be taxed on his property abroad or on his income from abroad?*

In international relations the principle of political allegiance is still largely followed. Thus in England, and many other countries, as formerly and again more recently in the United States, a resident citizen is subject to the income tax on his entire income, whether received abroad or not. If, as is usually the case, the income is again taxed where it is earned we have a glaring case of double taxation. It is only in the inheritance tax that the principle of citizenship has begun to be weakened, and that the doctrine of location is applied to a small extent.

In state and local taxation the principle of economic interest has made more headway. In the United States, as well as in several of the German commonwealths and Swiss cantons, the rule of *situs* is generally applied to real estate and to tangible personalty and business; the rule of domicile to other forms of property or revenue. In Germany the taxes on business, salaries and pensions, as well as on land, must be assessed according to location. But all these rules are only an approximation to the ideally correct principle.

In the case of business—whether individual or corporate—America is as yet in the rear of some of the European states. In purely local taxation the American commonwealths generally levy the entire property tax at the place of the principal office, although most of the business profits may be earned in other places within the state. In the case of corporation taxes, however, a few states now pursue the more sensible policy of taxing the domestic corporation only on that part of its capital or earnings which is employed or received within the state. This is perhaps as near as we can get at the present time to any practicable solution.

2. *Shall a non-resident citizen be taxed on his property abroad or on his income from abroad?*

This seems to involve a great stretching of the principle of political allegiance; yet we find it to be the practice at the present day in international relations. For instance, in the national income tax of 1894 in the United States, an American was taxed on his whole income, whether he resided in America or abroad. Some states, however, like England and Austria, do not carry the doctrine of citizenship to this point,—they make no attempt to tax a non-resident citizen on his

foreign income. Other countries cling only nominally to the principle, by providing for a remission of taxes in case the citizen is actually taxed abroad. And still others, like Russia, compromise the matter by exempting the citizen after he has lived abroad two years.

In state and local taxation, the tendency is far more evident to settle the matter according to the doctrine of economic interests. According to this principle, there is no imaginable reason why a non-resident citizen should be taxed for his property abroad. Moreover, neither the principle of location nor that of domicile has any application. Even if it were desirable to levy such a tax, it is difficult to see how the obligation could be enforced, unless the non-resident happened also to own some real estate at home. And even then, the home property would scarcely be liable for the taxes of the non-resident on his foreign income.

3. *Shall a non-resident citizen be taxed on his property at home or on his income earned at home?*

Here, again, the ideal solution would be, as in the first case, that the home government should levy not the entire tax, but only the greater part, leaving a small share to the foreign government. But in default of such an arrangement, the most practicable method is for the home government to levy the whole tax, and to trust to the foreign government to avoid double taxation.

As a matter of fact, this is the practice in international relations. Almost everywhere the income earned at home is taxable even though the citizen lives abroad; for in this case the principles of citizenship (or political allegiance) and of location come together. In state and local taxation, however, the practice is considerably modified by the principle of domicile, as applied to certain forms of personalty or income. We have seen the practice in America in regard to property; and in the few cases of income taxation, the custom is still further restricted. In Massachusetts and Virginia, for instance, the income tax applies only to residents.

4. *Shall a resident alien be taxed on his property or income in the state of residence?*

This, together with the two following cases, is the reverse of the preceding cases. It is indeed evident that the alien should not be treated with greater favor than the citizen. Accordingly, if the non-resident citizen be taxed, the resident alien should

certainly not be exempt in so far as the same property is concerned. In international relations most states have here abandoned the doctrine of political allegiance. There is no reason why it should not be abandoned; for the principles of domicile and of location here converge and, combined, far outweigh that of citizenship. In state and local taxation the matter is somewhat complicated by a survival of the old jealousy of strangers. Not only is the resident alien taxed, but he is sometimes taxed at a higher rate than the citizen, or is taxed when the citizen is exempt. We find this, for instance, in the United States where a higher rate is imposed on certain foreign companies (*i.e.* resident aliens). A way out of the difficulty has been outlined in the so-called reciprocal laws, according to which a state taxes resident aliens in the same way that its citizens resident in the foreign state are there taxed.[1] The wholesome dread of reprisals is often sufficient to prevent unjust double taxation.

5. *Shall a resident alien be taxed on his property abroad or on his income earned abroad?*

This case is not quite so simple. We have seen that if we abandon the principle of political allegiance and substitute that of economic interest, a large part of the tax should be paid to the country where the property is situated, and only a small part to the country of domicile. But where this ideal cannot be attained, we found it simpler to apply, as far as possible, the doctrine of location.

In international relations it is to be noticed that almost all states have abandoned the doctrine of political allegiance and have substituted that of domicile. That is, in England and in most of the German states residents are liable to the income tax on their whole income, whether they are aliens or citizens, and whether the income is derived from the home country or from abroad. This was also the case in the 1894 income tax in the United States. To put it in another way: when the principle of citizenship is advantageous to a state, it is applied; when it is disadvantageous, it is not applied. Only a few countries exempt the foreign property or income of a resident alien. If the foreign state applies the principle of citizenship and the home state the principle of domicile, as is frequently the case, it is not to be wondered at that there should be so much double taxation.

[1] See *infra*, chap. vi, sec. ii., § 2.

In state and local relations the doctrine of economic interests has made considerably more headway. Little attention is paid to the question whether the resident is a citizen or a foreigner, or whether we are dealing with a foreign or a domestic business or corporation. The problem is solved very much as in the case of the resident citizen.

6. *Shall a non-resident alien be taxed on his property or income in the state?*

In international relations, here again, the principle of political allegiance has been abandoned, and that of location has been substituted. It is the almost universal custom for states to levy a tax on incomes arising within their borders, irrespective of the question whether the recipient lives abroad or is a foreigner. The income tax law of 1894 in the United States formed no exception. The difficulty arises in the practical enforcement of the law, where the property or the source of income does not consist of tangible property.

In state and local taxation the problem is comparatively simple as regards tangible property, which is taxed where it is located. But in the case of intangible property, not capable of a *situs*, the question arises whether it should follow the domicile of the owner, and to that extent be beyond the jurisdiction of the taxing power; or whether the intangible property may not be declared to have at least an economic *situs* in connection with the tangible property on which it is based or which it represents. In so far as corporate securities are concerned, this question will be treated in a subsequent chapter. In the case of earnings from business, since there must generally be an office or an agent in the state through which the earnings are received, the alien (or foreign business or corporation) is to that extent no longer a non-resident. But even here the principle of economic interest is clearly applicable.

In the case of the inheritance tax international complications have recently assumed important dimensions. In the British empire the difficulty has become especially acute in view of the high inheritance taxes levied simultaneously by the mother country and by the states of Australasia or South Africa. At the last imperial conference in London this was made the subject of urgent representation by New Zealand; but the British government could not see its way to abandon the large revenues now derived on the estates of non-resident citizens.

Of recent years the problem of double taxation has also be-

come acute in the United States in the case of the inheritance tax which is now so widespread.[1] At first, as in the case of the general property tax, while real estate was usually taxed only in the state of its *situs*, most of the commonwealths taxed not only all the personal property of resident decedents but also such personal property of non-resident decedents as was actually or technically within the state, as moneys or securities in the local banks or deposit companies, or other evidences of debt. Some states even went further and taxed the securities of corporations organized under their laws, even though the decedent was a non-resident and the securities were in some other state. In this way there was the possibility of not only double, but triple or quadruple taxation. For if the citizen of state A, whose entire fortune consisted of railroad bonds, happened to die in state B, leaving on deposit in state C the securities of a railroad organized in state D but actually operating in state E, his whole estate might be taxable by each of the five states. A case actually occurred a few years ago in New York where a decedent's estate was compelled to pay no less than four taxes to different states on the same portion of the estate.

About one-half of the American commonwealths still follow the old method. Several states, however, now endeavor to avoid double taxation by maintaining the principle that personal property should be taxed only at the domicile of the decedent.[2] Others, again, have adopted this principle only in part. Maine and Vermont, for instance, allow a resident decedent's estate credit to the extent of taxes imposed on the same inheritance by another state. As to non-resident decedents, however, their personal property in the state is still taxable, but only to the extent that the amount of tax may exceed the amount imposed by the state of the decedent's domicile. A few states, again, have a reciprocal provision. Massachusetts, for instance, allows a credit for taxes paid to other states, but only if the law of such other state contains a similar reciprocal provision. Finally in a few states we find retaliatory provisions. Connecticut, for instance, taxes the stock or registered bonds of domestic corporations to non-resident decedents only when the

[1] *Cf. infra*, chapter v.

[2] Such are Arkansas, Idaho, Kentucky, Louisiana, Maryland, Minnesota, Missouri, Montana, Nebraska, New York, North Dakota, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia and Wyoming.

state of residence taxes similar securities of its own corporations when owned by a decedent of Connecticut.

This whole subject was considered by a committee of the National Tax Association, which reported a so-called model law in 1911.[1] The committee recommended the adoption of the simple rule that the tax should be imposed, in the case of residents, upon all their intangible property and upon such tangible property as was within the state; but that in the case of non-residents the tax should be imposed only on the tangible property within the state. The New York law of 1911 followed this recommendation.[2] The same principle was adopted by Massachusetts in 1912 and by some other Eastern states at about the same time. But the Western states were never reconciled to this method, and within a few years most of the Eastern states reverted to the old rule. Even had the principle prevailed, however, the possibility of double taxation would by no means have been eliminated. Residents of a large financial centre like New York are especially exposed to simultaneous taxation on the securities of foreign corporations,[3] and will remain so unless a provision is adopted as in Switzer-

[1] *Addresses and Proceedings of the Fourth International Conference of the International Tax Association*, Columbus, 1911, p. 279 *et seq.* In 1914 and 1915 we find suggestions that the tax should be imposed only by the state in accordance with whose laws the property devolves. *Cf. Eighth Conference*, p. 233; and *Ninth Conference*, p. 377. More recently other plans have been suggested.

[2] The history of the New York law is typical. The original law of 1885 did not tax the personal property of a non-resident decedent. An amendment of 1887 was designed to accomplish this, but the law was so worded that the result ensued only when the decedent also owned real estate within the state. In 1892, however, this condition was abrogated. In 1911 only tangible property of a non-resident decedent, located within the state, was taxable. But in 1915 shares of stock, securities of real-estate corporations and interests in partnerships, in the hands of non-residents, were again made taxable. In 1916 capital invested in business or earned within the state was added. In 1919 shares of domestic corporations and national banks were added. Finally in 1922 shares of joint stock companies and associations and good will of partnerships were added.

[3] We are told, for instance, that the securities of about 450 large corporations are dealt in on the stock exchange of New York. Of these, 32 are incorporated in New York, 84 in New Jersey, 70 in Massachusetts, 33 in Michigan, 33 in Maine, 27 in Pennsylvania, 21 in Illinois, and 14 in New Hampshire. In all these states, except Pennsylvania, a tax is imposed on the stock of such corporations when owned by a decedent of New York. *Cf. Annual Report of the Comptroller of the State of New York*, Albany, 1912, p. xiii.

land or as in Maine and Vermont. Moreover, it is not very probable that the Western states which suffer from absentee ownership will agree to abandon the taxation of the securities of railroads owned in the East. As long as the present conditions continue it is most desirable that some interstate arrangement be effected whereby only such proportion of the securities be taxed as corresponds to the mileage or other criterion of property within the state.

From the above review, it is evident that the question where a tax ought to be imposed involves a rather simple theoretical problem and many very difficult practical problems. It is the same with almost every question of taxation. As a matter of principle, it is easy to decide that a man should be taxed according to his faculty; as a matter of practice, it is not so easy to apply the principle of faculty in the actual tax system. So we have found that in the case of double taxation due to conflicts of jurisdiction the ideal principle is that of economic interest or economic allegiance, modified in a few cases by that of political allegiance. The difficulty arises when we attempt to embody this principle in equitable assessments.

If we observe the legislation of the most progressive countries, we find, especially as regards internal or federal relations, a distinct tendency toward the realization of this principle. Economic interests are divided between the places of location, of domicile and of residence. However differently various states may measure the relative importance of each, there is a steady progress toward the recognition of the principle. In the case of real estate the solution is obvious; in the case of intangible personalty, of business earnings and of interest from loans the problems are far more complicated. To work out the solution [1] for each kind of tax would take us too far afield. But it cannot be too strongly emphasized that in federal states no satisfactory system of taxation can be attained until two conditions are realized. We need, in the first place, a substantial interstate agreement to pursue the same general policy in cases of conflicting jurisdiction; and we need, in the second place, a virtual acceptance of the doctrine of economic interests in taxation. When once these conditions exist, it will make comparatively little difference how the principle is interpreted. For if it is everywhere interpreted in the same spirit, there can be

[1] For a study of the practical problem as applied to the corporation tax, see *infra*, chapter viii, sec. iv. *Cf.* in general the monograph of Walker.

little double taxation; and with increasing experience we may expect to find closer and closer approximation to strict justice in the application of the principle. In international relations we are still very far removed from the ideal; in internal taxation—federal, state and local—the drift is unmistakably in the right direction.

NOTE TO 10TH ED. The recent enormous increase in the rates of the income tax and the inheritance tax have everywhere brought the problems of interstate double taxation to the fore. In the United States a committee of the National Tax Association on the federal income tax, of which the writer was chairman, recommended a provision, later incorporated in the income tax law, whereby a credit is allowed for income tax paid abroad by citizens, and in the case of resident aliens when the foreign country allows a similar credit to citizens of the United States. *Cf. Proceedings of the 10th Conference*, 1917, p. 130. In Great Britain the law of 1920, following a recommendation of the Income Tax Committee of that year, permits relief from double income tax only within the empire. Relief for dominion income tax is granted up to one half of the British rate. For a discussion of some recent complications see an article by the present writer, "The Taxation of Non-Residents in the New York Income Tax," in *The Bulletin of the National Tax Association*, vol. v (1920), pp. 40–50.

The International Chamber of Commerce has dealt with the subject in *Brochure no. 11. First Congress, 1921. Double Taxation. Part I. Report of the Select Committee*; *Brochure no. 12. Part II. Special Report of the British National Committee*; and *Brochure no. 25. Congress of Rome, 1923, Double Taxation.* Paris, n. d. [1924].

The League of Nations invited a committee of experts to consider the subject and published their conclusions as *Report on Double Taxation submitted to the Financial Committee* by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, Geneva, 1923. This served as the basis of the *Reports on Double Taxation and Fiscal Evasion* by the Government Experts, 1924–1925. For a commentary see G. Schanz, "Die Doppelbesteuerung und der Völkerbund," *Finanz Archiv*, v. 40 [1923], p. 353.

For other literature see Kaufmann and Taeschner, *Die Steuerpflicht der Auslandsdeutschen, der Ausländer und der ausländischen Gesellschaften.* Berlin, 1922.

CHAPTER V

THE INHERITANCE TAX

THE inheritance tax,[1] as now understood in most countries, is essentially the product of modern democracy. It was, indeed, not unknown to antiquity. In Rome the *vicesima hereditatium*, a tax of a twentieth part of inheritances, was imposed at the beginning of the empire to pay the pensions of the veteran soldiers. In the middle ages the relief and the *heriot* were exacted by the overlord in return for the privilege of succeeding to the possession of property. But while the influence of the mediæval idea is still to be seen in a few of the continental countries where the payment is regarded as made for the privilege of succession, the tax is almost everywhere of independent and comparatively recent origin. In Holland, in France and even in England, parts of the existing inheritance taxes are survivals of the system of charges on transfers and transactions.[2] In many English-speaking states the term *probate duties* is still employed, signifying that the original conception was a charge for the privilege

[1] *Cf.* M. West, *The Inheritance Tax* in Columbia *Studies*, 1893, 2d ed., 1908; A. W. Soward and W. E. Willan, *The Taxation of Capital*, London, 1919 (containing on pp. 75–78 a bibliography of the British death duties); v. Scheel, *Erbschaftssteuern und Erbschaftsreform*, 2d ed., 1877; Eschenbach, *Erbrechtsreform und Erbschaftssteuer*, 1891; Krüger, *Die Erbschaftssteuer*, 1889; P. Audé, *De l'impôt sur les mutations par décès*, Paris, 1896; E. Sevené, *Impôt sur les successions*, Montpellier, 1900; Garelli, *L'imposta successoria*, 1896; and several articles by Schanz in *Finanz Archiv*, vols. xv-xviii. The earliest book on the subject is the anonymous *Ueber Erbschaftssteuer oder lachende Erben-gebühr*, Erlangen, 1790.

For the United States see A. W. Blackmore and H. Bancroft, *The Inheritance Tax Law containing all American Decisions and existing Statutes*, Boston, 1912; and H. Bancroft, *Inheritance Taxes for Investors*, Boston, 1911, 2d ed., 1917.

[2] *Cf.* P. Haensel, "Die mittelalterlichen Erbschaftssteuern in England" in *Deutsche Zeitschrift für Kirchenrecht*, vols. xix, xx; and his *L'impôt sur les successions en Angleterre*, Moscow, 1907.

of having the will probated; and in some places the various forms of the inheritance tax are included among the stamp taxes, or taxes on transactions. But in most countries the older idea has been abandoned. The inheritance tax is to-day found primarily in democracies like those of England, Switzerland, Australia and America; and in other countries its development has gone hand in hand with the spread of democratic ideas.

It may be asked why democracy should favor the inheritance tax. The answer depends upon the point of view from which we regard democratic tendencies. If we say, as some believe, that the trend of democracy is necessarily toward socialism, the answer is plain: the inheritance tax is imposed because democracy is jealous of large fortunes. But if, on the other hand, we hold with the less pessimistic critics that modern democracies are endeavoring simply to do away with the abuses that have come down to us from the aristocracies of the past, we may claim that the inheritance tax is only a means of securing equality in taxation and of realizing the principle of ability to pay. Because the tax has frequently been urged by those who are opposed to large fortunes, it has usually been overlooked that it may be defended on purely economic grounds as in complete harmony with the general principles of equitable taxation.

The earliest argument for the inheritance tax had its origin in Bentham's plan to abolish intestate inheritance; that is, to provide, when there was no will, for the devolution of the property to the state.[1] The title of the essay is explained in the following problem:

"What is that mode of supply of which the twentieth part is a tax, and that a heavy one, while the whole would be no tax, and would not be felt by anybody?"

The solution of the problem, according to Bentham, lay in the abolition of intestate succession except in the case of immediate relatives. To this he added the limitation of the power of bequest of testators without direct heirs. The old principle of escheat was to be extended to include the inheritances or bequests then going to collateral relatives. But Bentham

[1] The full title is "Supply without Burden, or Escheat *vice* Taxation, being a Proposal for a Saving of Taxes by an Extension of the Law of Escheat, including Strictures on Collateral Succession comprised in the Budget of 7th December, 1795." In Jeremy Bentham, *Collected Works*, Bowring's edition, ii., p. 585.

claimed, further, that the state should have an equal share in the sums going with or without a will to such close relatives as grandparents, uncles and aunts, and perhaps nephews and nieces, as well as a reversionary interest in the succession of childless direct heirs without prospect of children.[1]

Bentham held that this was not a tax, and that precisely in this fact lay its chief advantage,—that of "unburthensomeness," or, as we would say, freedom from oppressiveness. According to the general principles of human nature, said he, a man is led in the case of a tax on successions to look upon the whole of what is left to him as his own, of which he is then called upon to give up a part. But if under the law regulating successions he knows that nothing, or only a small share, is due him, Bentham claimed that he would suffer no hardship. "For hardship depends on disappointment; disappointment upon expectation, and if the law of succession leaves him nothing, he will not expect anything." [2]

Exaggerated as Bentham's distinction undoubtedly is, it contains a kernel of truth; namely, that there is no such thing as a natural right of inheritance, and that the extension of intestate succession to collateral relatives is under existing social conditions defensible only to a very limited extent. Whatever may have been the original family theory of property, it may be argued with some force that the bonds of the wider patriarchal family life have been considerably loosened in modern times, and that the family consciousness extends nowadays only to the nearest relatives.

While Bentham looked upon the matter primarily from the

[1] The plan is defined to be "the appropriating to the use of the public all vacant successions, property of every denomination included, on the failure of near relations, will or no will, subject only to the power of bequest, in respect of the half of whatever property would be at present subject to that power."

[2] As he puts it in another place: "The riddle begins to solve itself: a part taken and a sense of burthen left; the whole taken and no such effect produced; the effect of a part, greater than the effect of a whole; the old Greek paradox verified, the part greater than the whole. Suffer a mass of property in which a man has an interest to get into his hands, his expectation, his imagination, his attention at least fastens upon the whole. Take from him afterward a part . . . the parting with it cannot but excite something of the sensation of a loss. . . . Take from him now (I should not say *take*), but keep from him the whole, so keeping it from him that there shall never have been a time when he expected to receive it; all hardship, all suffering, is out of the case."

point of view of escheat, it was but a step to extend the argument, and to say, as many writers now do, that, since it is exceedingly difficult to draw a sharp line where the family consciousness ends, it is more just and more practicable for the state to take away a small part from direct relatives and an increasingly larger sum from the more remote relatives. The tax, in other words, would be graduated according to the degree of relationship. What was originally nothing but an extension of escheat, thus grew into the idea of a graduated collateral inheritance tax. Even Bentham himself, although protesting against the use of the word *tax*, virtually advocated a graduated tax when, as we have seen, he proposed the exemption of direct heirs; the confiscation of fifty per cent from grandparents, uncles and aunts; and the seizure of the whole in case of intestacy. Thus the extension-of-escheat argument, which was meant originally to apply only to intestacy, has been made to include also a limitation of the power of bequest.

A supposed variation of this line of reasoning is seen in what is called the theory of state co-heirship or co-partnership. It originated with Bluntschli, who used the expression *staatliches Miterbrecht*, and has found its way into some recent treatises. Its most vigorous recent defender is Andrew Carnegie, who is as enthusiastic about a progressive inheritance tax as he is opposed to an income tax.[1] Sometimes Bentham is cited as the originator of the doctrine, but this is a mistake. As Dr. West so well puts it:—

"Bentham's plan was to abolish intestate inheritance except between immediate relatives, to restrict the power of bequest of testators having no direct heirs, and to give the state a part of the property of decedents in certain cases. He called the system which he proposed an extension of escheat, and based it not upon any right of inheritance in the state, but upon the absence of any reason for the operation of intestate inheritance between individuals not closely related. It is therefore a mistake to call Bentham a representative of the theory of state co-heirship. But later writers have combined with his argument the thought that the state should inherit property from individuals because of what it does for them during their lives. The state is sometimes represented as a larger family; according to Umpfenbach, the bond of kinship between distant relatives loses itself in the whole nation, which therefore inherits the property of individuals as

[1] Mr. Carnegie stated that the "American republic is the partner in every enterprise where money is made honorably." *Cf.* Seligman, *Progressive Taxation*, 2d ed., 1908, p. 322.

the family inherits the property of its members. Such expressions as these, however, must be regarded as metaphorical rather than scientific. The state may acquire property by escheat, but not by inheritance. Inheritance implies kinship, and the modern state is not a genetic association. The representation of the state as co-heir is either a mere figure of speech (and as such it is as old as Pliny), or else it results from a confusion of inheritance and escheat. Inheritance is not a matter of public law; it is for private law to prescribe how far inheritance shall be permitted between individuals, and for public law to ordain that where inheritance ends escheat shall begin." [1]

We now come to the second theory, which may be called the socialistic or diffusion-of-wealth theory. It is based upon the doctrine that it is the function of government to use the power of taxation as an engine of social reparation in checking the growth of large fortunes and in bringing about a more equal distribution of wealth.

In its origin this theory was not socialistic. John Stuart Mill accepted Bentham's reasoning, but developed it. Since he did not consider the right of inheritance as necessarily involved in the private ownership of property, he desired to extend the abolition of intestate succession to direct heirs, as well as to collateral relatives. Moreover, even in the case of a will, no one, he thought, was justified in demanding more than a fair competence. His plan was as follows:—

"That no one person should be permitted to acquire by inheritance more than the amount of a moderate independence. In case of intestacy, the whole property to escheat to the state: which should be bound to make a just and reasonable provision for descendants, that is, such a provision as the parent or ancestor ought to have made, their circumstances, capacities, and mode of bringing up being considered." [2]

This argument is not necessarily socialistic; but it is perhaps open to question on other grounds. It may be regarded as opposed to the family theory of property, which even in its narrower sense, assumes that as a man acquires property largely in order to leave it to his children, for whom he ought to provide, there is reasonable ground for demanding the perpetuity of the means of family support. Denial of the right of inheritance by direct heirs thus seems to involve an attack upon the unity of the family. On the other hand, the right

[1] *Political Science Quarterly*, viii., p. 436.

[2] *Political Economy*, book v., chap. ix., sec. i. *Cf.* book ii., chap. ii., secs. iii., iv.

of inheritance within the family has already been largely modified by the freedom of bequest; and if a man is at liberty to give away his whole fortune to outsiders, we cannot well speak of a family right. In parts of continental Europe, indeed, we have the survival of the old idea in the institution of compulsory children's share (*portion légitime, Pflichttheilsrecht*). Even in the United States some of the commonwealth laws prohibit the bequeathing of more than a certain portion of the estate to charitable or public uses when there is a child, a widow or a parent. But, as a general rule, in English-speaking countries the right of bequest is free. It is well known that inheritance is older than bequest, and that the latter system was introduced into the Roman law, not to limit inheritance, but to provide heirs in default of near relatives. The modern right of free bequest is, therefore, really opposed to the older family idea of property, which takes shape in the assertion of the right of inheritance. It thus becomes a very difficult question to decide how far inheritance may be demanded as of right. Nevertheless, it may be said that most thinkers, as well as the mass of the public, would still to-day maintain the custom of inheritance, not indeed as a natural right or as a necessary consequence of the right of private property, but as an institution that is on the whole socially desirable.[1]

While there is some scientific justification for the doctrine as originally expounded, it is unquestionable that most of its defenders plant themselves squarely on the ground that it is the function of the state to check the aggregation of wealth into a few hands, and to provide for the equalization of fortunes. These writers would put a limit not only to the amount of wealth acquired through inheritance or bequest, but to the amount acquired in any manner. No fortunes should exceed a definite sum. Such a doctrine is very distinctly socialistic. Those who are not prepared to accept socialistic premises and socialistic methods of reasoning cannot acknowledge the validity of the diffusion-of-wealth argument.

While the premises may thus be regarded as wrong, the conclusion may nevertheless be right, for the same conclusion may conceivably be drawn from utterly dissimilar premises. Just as

[1] The proposition that inheritances not due to the saving of the decedent should be taxed at higher rates is advanced by E. Rignano, *Di un socialismo in accordo colla dottrina economica liberale*, Turin, 1901, and *Per una riforma socialista del diritto successorio*, Bologna, 1920. *Cf.* his "A Plea for a greater Economic Democratization" in *The Economic Journal*, xxix (1919), 302.

it has been elsewhere shown that progressive taxation may be upheld by decided opponents of socialism,[1] so it can be shown beyond dispute that the inheritance tax may be supported through entirely different arguments by those who oppose the doctrine of the diffusion of wealth. Brushing aside, therefore, the socialistic doctrine as inadequate and unsound, let us examine these other arguments.

The so-called cost-of-service theory, which is occasionally found, treats the inheritance tax simply as a fee. The probate courts are a source of expense to the government and a source of special benefit to those that utilize their services. What is more reasonable, then, than that those who receive the special benefit should defray the cost?

This argument, however, would justify only very light charges, and it would result not so much in an inheritance tax as in a system of probate fees. Such probate fees are occasionally found;[2] but as soon as they exceed the cost, the theory is no longer applicable. The probate duty in England, for instance, soon outgrew its original character of a fee. Another objection to this theory is that logically the charge ought to be regressive, not proportional or progressive; that is, since it costs proportionally less, to probate a large sum than a small sum, the rate ought to be lower on a large inheritance than on a small one—or, at all events, it ought not to grow with the size of the inheritance. As a matter of fact, the inheritance tax of 1889 in Wisconsin was regressive.[3]

A somewhat more substantial theory is that which considers the inheritance tax as the price of a special privilege. It is regarded not so much as a fee paid to defray the cost of government services as a charge proportioned to the advantages that accrue to the recipient of the inheritance. From the legal point of view, this has much to recommend it. In the United States, for instance, if regarded as a tax on property, the charge would conflict with the constitutional provision found in many

[1] See Seligman, *Progressive Taxation in Theory and Practice*, 2d ed. (1908), p. 142.

[2] So in the American commonwealths, as Wisconsin, Minnesota, Illinois and New Hampshire.

[3] Estates not exceeding $3,000 were exempt; up to $500,000 they paid one-half of one per cent; on the excess above this, one-tenth of one per cent. The charge was declared to be "in lieu of fees," but it was held to be a tax, and therefore unconstitutional because applicable only to one county. 76 Wis. 469. See West, *op. cit.*, p. 77.

commonwealths, requiring all property to be taxed equally. If a general property tax were levied, and then an additional inheritance tax were imposed, we should have technically unequal taxation of some property. Again, the tax, if imposed by the federal government, would militate against that section of the constitution which requires all direct taxes to be apportioned according to population. Accordingly, many of the American states have contrived to uphold the constitutionality of the tax only by declaring it to be a tax on the devolution of property. It is declared to be a tax not on wealth, but on the transfer of wealth. So the Louisiana inheritance tax was originally upheld by the federal Supreme Court as a simple regulation of inheritance.[1] But since the federal government possesses no constitutional power to regulate inheritances, the federal inheritance tax was sustained as being neither such a regulation nor a direct tax on the land, but an excise on the right to succeed to the ownership of property.[2]

From the economic point of view, there is a partial justification for this contention. It is indeed true that if the inheritance tax is to be regarded as an indirect tax on transactions or transfers, it might be declared obnoxious to the general tendency of modern theory to restrict the scope of taxes on acts and transactions to their narrowest limits. But this opposition to taxes on economic phenomena, as we shall see later [3] has been pushed too far. Again, to regard the tax as a charge on the mere privilege of succession, is in reality to merge it with the theory to be discussed in the next paragraph, because of the undoubted fact that the result of the privilege of succession is to enhance the ability of the recipient.[4]

We come then to the theory which regards the inheritance tax as a direct tax on the recipient of the inheritance. If we grant that the basis of taxation is the faculty of the individual, it is evident that any addition by inheritance to the wealth of the individual increases his ability to pay. If we grant, further, that the best test of faculty is the revenue of the individual, it is clear that this accretion to his revenue is of a peculiar character. Income, as the term is commonly employed, denotes a regular periodic return; but an inheritance is an irregular, a spasmodic, a chance return. In a logical

[1] Mager *vs.* Grima, 8 How. 490. [2] Scholey *vs.* Rew, 23 Wall. 331.
[3] *Cf. infra*, chap. ix.
[4] As to the relation between privilege and ability, *cf. infra*, chap. x, sec. 3.

income tax there is no room for such accidental or fortuitous revenues. Yet they clearly add to the ability of the individual, just as the chance gains from speculation undoubtedly increase the faculty of the taxpayer. From this point of view, the inheritance tax may best be defended by the accidental, or fortuitous-income argument.

It may be claimed that there are possible cases where this argument is inapplicable. Thus, after a man's death, his widow or children may have to depend entirely on the income from his property, where before his death they enjoyed not only this sum but also the additional income due to his personal exertions. The family ability to pay may be diminished, not increased. It may be answered that the state deals with individuals, not with families, and that the individual members now have incomes where before they had none. And even if we concede this claim, the difficulty can be met by exempting a certain amount, and imposing a progressive tax on the remainder. For in proportion as the family income was derived from property, rather than from the labor of the head of family, the share due to his influence becomes correspondingly smaller, and the loss due to his absence will be less keenly felt; while, on the other hand, the family expenses themselves are diminished by his death. Finally, in proportion as the inheritance goes to self-supporting direct heirs or to collateral relatives, it may be maintained with truth that there is a decided increase in tax-paying ability.

When, therefore, we have a system of income taxes, the inheritance tax may be regarded as a supplementary tax to reach the real ability of the individual. Moreover, it may be regarded as a convenient method of applying the principle of differentiation in the taxation of income. It is now commonly recognized that incomes from property should pay a higher rate than incomes from labor. Instead of making a difference in the rates to reach this end, the proportional income tax may be supplemented by a property tax; or where this is for any reason undesirable, by the inheritance tax. The latter would then serve the double purpose of reaching not only accidental incomes, but also property incomes, since all inheritances take the shape of property.

Even in those states where the chief direct tax is that on general property, the inheritance tax may be defended on the accidental-income theory. For in so far as property is at all

an adequate test of faculty in taxation, it is simply a mode of estimating the regular revenue or income. Accidental income is as little taken note of in a property tax as in an income tax. In fact, as between the two systems, an inheritance tax is more necessary to supplement the former tax than the latter.

An additional theory which has been advanced more recently is the so-called back-tax theory. Since general property taxes are to a large extent evaded during life, it is said to be no more than just that the property should be made to pay when the tax cannot be evaded. But in this case it is the property of the decedent, rather than the ability of the heir, that is considered. Moreover, the validity of the argument is questionable chiefly because it is well-nigh impossible to prove the relation between the amount of the inheritance tax and the aggregate of taxes evaded during life. In the United States, for example, taxes on realty are generally paid; it is the tax on personalty that is evaded. The inheritance tax ought then to take the shape only of a tax on the successions to personal property. As an actual fact, this was for some years the case in New York and several other states in the direct inheritance tax. The reasoning, therefore, does not apply to real estate at all. Finally, in proportion as other taxes are substituted for the personal property taxes, the argument falls away. Where there is a property tax or an income tax, there may well be some provision for an inventory of the estate after death (as in Switzerland and Germany) with severe penalties for the evasion of back taxes. But such a provision is entirely independent of the inheritance tax.

The theory sometimes advanced [1] that the inheritance tax is to be regarded as a capitalized income tax paid once and for all at the close of life, instead of in small amounts during each year, is not so strong. In the first place, the existing tax system either does, or does not, reach the income or property of the living taxpayer. If it does, as it ought to do, to capitalize what has already been paid involves double taxation. If it does not, the tax is still objectionable on the score of inequality, because when two people with the same fortune die at different ages and pay the same tax, the amount, if regarded as a capitalized income tax, would mean a very divergent rate of income tax. If the tax payable by A, who has enjoyed his income forty

[1] Bastable, *Public Finance*, p. 526.

years, is equivalent to the capitalization of a five per cent income tax, the amount payable by B, who has enjoyed his income only ten years, would be tantamount to a twenty per cent income tax. An inheritance tax, from this point of view, would be grossly unjust. This objection, due to the varying frequency of the transfer, was first made by Adam Smith, but is applicable only when the tax is considered as a tax on the estate as the whole. According to the accidental-income argument, the frequency of transfer is immaterial; for the tax is paid each time by a different person.[1]

The accidental income argument regards the inheritance tax as a personal tax; the privilege-of-inheritance theory regards it as an impersonal tax. In the one case it is a tax on the individual; in the other a tax on the thing—i. e. the inheritance or the privilege of inheritance. The one theory results in the imposition of the tax on the share of the recipient; the other theory, while possibly leading to the same result, is a tax susceptible of being interpreted as involving the imposition of the tax on the estate as a whole.

The logical defence for the inheritance tax is thus the accidental-income argument as supplemented by the privilege-of-inheritance argument. Where the tax is proportional this makes no difference, for the sum of the shares is equal to the entire estate. But where we have a graduated tax, the difference is marked. The higher rates on the larger amounts obviously result in greater revenue when the tax is imposed on the estate than if levied on the shares. But if A receives $10,000 from a $50,000 estate, and B receives a like amount from a million-dollar estate, it does not comport with justice from the individual point of view that B should be taxed ten times as much as A simply because the rate on a million dollars happens to be ten times that on $50,000. This principle of taxing the share as well as the estate is now gradually being recognized. England pursues both plans, taxing the estate as a whole through the estate duty, and the separate shares through the legacy and succession duties. In the United States the federal tax is

[1] Some states exempt the second devolution, if it takes place within a certain number of years. Chili fixes the term at ten years. See West, *op. cit.*, p. 33. In Great Britain since 1914 relief is afforded in case of "quick succession" by granting an allowance of 50% if the second death occurs within 1 year, 40% within 2 years, 30% within 3 years, 20% within 4 years, and 10% within 5 years.

imposed on the estate while most of the commonwealth taxes are levied on the shares.[1] A few states like Rhode Island employ both methods.

Granting the desirability of the tax, we are at once confronted by the problem of graduated or progressive taxation. Graduation of the tax according to relationship has met with well-nigh universal acceptance; graduation of the tax according to amount has given rise to more controversy. This question has been fully discussed in another place [2] with the conclusion that the theory of progression is more applicable to the inheritance tax than to any other part of the fiscal system; and that, whether we base our demand on the limitation-of-inheritance theory, the faculty theory or the compensatory theory, some scale of progression is both desirable and practicable.

The inheritance tax to-day scarcely needs defence. It is found in almost every country; and the more democratic the country, the more developed is the tax. In some of the Canadian provinces, in the Australasian states, in the Swiss cantons, in England itself, the rates are not only progressive, but highly progressive. The recent reforms in England are fully described in another chapter.[3] In the United States also, there is now a decided movement toward the progressive inheritance tax. The collateral inheritance tax is virtually the product of the last two or three decades. Up to 1890 it existed in only six states,[4] but between 1890 and 1900, it was adopted by fifteen additional states, making twenty-one in all.[5] During the next decade this number was increased by seventeen states [6] and in

[1] For a defence of taxing the share instead of the entire estate see the *Report of the Special Tax Commission of New York* of 1907, of which the author was a member. *Cf.* especially the section on the Inheritance Tax.

[2] *Cf.* Seligman, *Progressive Taxation*, 2d ed. (1908), pp. 319–322.

[3] *Infra*, chap. xvi.

[4] The date when first imposed is put in brackets: Connecticut [1889], Delaware [1869], Maryland [1845], New York [1885], Pennsylvania [1826], West Virginia [1887].

[5] California [1893], Illinois [1895, although it existed for Cook county alone since 1887], Iowa [1896], Maine [1893], Massachusetts [1891], Michigan [1893–1894, and again from 1899], Minnesota [1897, although an earlier tax had existed from 1875 to 1886], Missouri [1895–1898 and again in 1899], Montana [1897], New Jersey [1892], North Carolina [1897, although an earlier tax had existed from 1847 to 1874], Ohio [1893], Tennessee [1891], Vermont [1896] and Virginia [1896, although an earlier tax had existed from 1844 to 1884].

[6] Arkansas [1901], Colorado [1901], Idaho [1907], Kansas [1909], Kentucky [1906], Louisiana [1904, although there existed from 1828 to 1877

the following decade by six states.[1] The collateral inheritance tax is therefore at present [1921] lacking only in Alabama (where it existed from 1848 to 1868), Florida and South Carolina. The tax was declared unconstitutional in six states,[2] but the constitutional objections were in every case obviated by later laws as indicated in the preceding notes.

The direct inheritance tax came somewhat later. It was first introduced timidly and with insignificant rates, and frequently applied only to personal property. Gradually the rates were increased, the exemptions were reduced and the tax was made applicable to real estate as well. The tax was first imposed in New York in 1891, but by the end of the century it had spread to six states.[3] During the next decade eighteen states [4] and in the following decade eighteen more states [5] were added to the list. As a consequence the direct inheritance is now [1921] found in all the states except six: Alabama, Florida, Maryland, Pennsylvania, South Carolina and Texas.

As to the rates, which are naturally higher in the collateral taxes, the most interesting recent development had been the gradual spread of the progressive principle. The first case in which that principle was applied was the direct tax of Ohio of 1894, which was declared unconstitutional for that reason by the state court in the following year.[6]

and again from 1894 to 1899 a tax applicable only to foreign heirs], Nebraska [1901], New Hampshire [1905, although an earlier tax had existed from 1878 to 1882], North Dakota [1903], Oklahoma [1908], Oregon [1903], South Dakota [1905], Texas [1907], Utah [1901], Washington [1901], Wisconsin [1903, although an earlier tax had existed from 1899 to 1902] and Wyoming [1903].

[1] Arizona [1912], Indiana [1913], Mississippi [1918], Nevada [1913], New Mexico [1919], and Rhode Island [1916].

[2] Louisiana in 1899, Michigan in 1894, Minnesota in 1886, Missouri in 1898, New Hampshire in 1882 and Wisconsin in 1902.

[3] The date when first imposed is put in brackets: Connecticut [1897], Illinois [1895], Michigan [1899], Montana [1897], New York [1891] and North Carolina [1897].

[4] In 1901 Colorado, Nebraska, Utah and Washington joined the ranks; in 1903 Oregon, Wisconsin and Wyoming; in 1904 Louisiana; in 1905 California, Minnesota and South Dakota; in 1907 Idaho, Massachusetts and West Virginia; in 1908 Oklahoma; and in 1909 Arkansas, Kansas and Tennessee.

[5] In 1911 Maine; in 1912 Arizona; in 1912 Georgia, Indiana and Nevada; in 1914 New Jersey; in 1916 Kentucky, Rhode Island and Virginia; in 1917 Delaware, Missouri, North Dakota and Vermont; in 1918 Mississippi and Virginia; in 1919 Kansas, New Hampshire, New Mexico and Ohio.

[6] State *vs.* Ferris, 53 Ohio State, 314.

In the same year, 1895, the progressive principle was applied to the collateral inheritance tax by Missouri and Illinois. The Missouri law was overthrown by the state court although for other reasons.[1] But the Illinois law, of a far more radical character, was upheld, not only by the state court but by the federal Supreme Court in what has become a leading case.[2] For it settled the principle that progressive taxation is not a denial of the equal protection of the laws demanded by the constitution, and thus made it difficult for any state court to annul a progressive tax because of some vague provision in the state constitution. When the same question arose in Wisconsin as applicable to the direct inheritance tax the Wisconsin court stated that the decision of the federal Supreme Court was conclusive.[3]

As a result of this decision by the Supreme Court, and in part also as a consequence of the highly progressive inheritance tax temporarily imposed by the federal government during the Spanish war and lasting from 1898 to 1902,[4] the progressive principle spread rapidly throughout the country. At the present time (1921) most of the states levying a direct inheritance tax enforce the progressive principle. The rates rise from 1 to 1¼% in Tennessee; from 1 to 2% in Illinois and Maine; from ½ to 3% in Mississippi; from 1 to 3% in Idaho, Indiana, Kentucky, Montana, New Jersey, Rhode Island, West Virginia and Wisconsin; from 1 to 4% in Connecticut, Delaware, New York, North Dakota, Ohio and South Dakota; from 2 to 4% in Colorado and Massachusetts; from 1 to 4½% in Minnesota; from 1 to 5% in Kansas, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Vermont, Virginia and Washington;

[1] State *vs.* Switzler, 143 Mo. 245.

[2] Kochesperger *vs.* Drake, 167 Ill. 122; Magoun *vs.* Trust and Savings Bank, 170 U. S. 283.

[3] Nunnemacher *vs.* State, 129 Wis. 190.

[4] The federal tax applied only to personal property over $10,000. On estates between $10,000 and $25,000, the rate varied according to five classes of relationship, from three-quarters of one per cent to five per cent. On estates from $25,000 to $100,000, these rates were increased one-half; from $100,000 to $500,000 they were multiplied by 2; from $500,000 to $1,000,000 by 2½; over $1,000,000 by 3. On the highest amounts the tax thus varied from two and a quarter to fifteen per cent. The federal tax was also upheld as constitutional in the leading case of Knowlton *vs.* Moore, 178 U. S. 41. The point in this case was as to whether the injunction of uniformity in the constitution meant anything more than geographical uniformity. The court, by deciding in the negative, upheld the law.

from 2 to 5% in Texas; from 3 to 5% in Utah; from 1 to 8% in Arkansas; from 1 to 10% in Oklahoma and Oregon; and from 1 to 15% in California. The maximum rates apply to inheritances varying in the several states from $100,000 to $1,000,000. The proportional tax is now found only in Arizona, Georgia, Michigan, Nebraska and New Mexico (at 1%); and in Louisiana and Wyoming (at 2%).

In the collateral inheritance tax the progression is naturally somewhat steeper, the maximum rates being applied to the large sums going to distant relatives or to non-relatives. The graduation rises to 5% in New Hampshire; to 6% in Arizona and Nebraska; to 7% in Maine; to 8% in Delaware, Massachusetts, Mississippi, New York and Rhode Island; to 9% in North Carolina; to 10% in Colorado, Illinois and Oklahoma; to 12% in Texas; to 15% in Idaho, Indiana, Kansas, Kentucky, Minnesota, Montana, Virginia, Washington, West Virginia and Wisconsin; to 20% in Iowa, North Dakota, Ohio and South Dakota; to 21% in Georgia; to 24% in Arkansas; to 25% in Nevada and Oregon; and to 30% in California and Missouri.

Finally it might be added that not alone have the rates been advanced, but the exemptions have been gradually reduced. In the collateral inheritance tax the exemptions are now usually from $100 to $500. In the direct inheritance tax the exemptions are much higher, rising to $15,000 in Missouri, Oklahoma and West Virginia; to $20,000 in Illinois and Nevada; to $24,000 in California; to $25,000 in Rhode Island; and to $75,000 in Kansas.

More recently the fiscal needs of the Great War brought about a marked increase in the scale of graduation throughout the world. In the United States the federal estate tax rose in 1916 to 10% on sums over five million dollars; in 1917 to 20% and in 1919 to 25% on sums over ten millions, so that in 1921 it was possible for a large estate going to a distant relative to pay as much as 55% in state and federal taxes. In Great Britain where the tax on shares through the Legacy and Succession Duties has since 1894 reached 10%, the additional Estate Duty reached in 1914 the rate of 20% on estates over 1 million pounds, and in 1919, 40% on estates over 2 millions, thus making a possible maximum of 50%. In Germany by the law of 1919 while the estate tax (*Nachlass-steuer*) rises only to 5% on sums over a million marks, the tax on shares (*Erbanfall-steuer*) reaches the rate of 70% on sums over 1½ mil-

lion marks going to distant relatives, thus making a possible total of 75%. In France under the law of 1920 an estate of the largest size (over 500 million francs) is taxed up to 39% by the *impôt sur le capital net global de la succession,* while the additional tax on shares (*droit de mutation*) rises, in the case of relatives beyond the fourth degree, to 59%. In order to prevent the confiscation of practically the entire amount (or 98%), the law provides that in no case shall the joint rate exceed 80%. This is the highest figure yet reached in history.

A comparison of the recent fiscal development in democratic states would not be uninstructive. In only three countries does the old general property tax still survive—in Switzerland, in Australia and in the United States; and in all three the system has become so defective that it has been supplemented by other sources. The Swiss cantons first developed the income tax, then the inheritance tax, and have only recently been paying attention to the corporation tax. The Australian colonies were first in the field with the inheritance tax, later developed the income tax, and have scarcely yet realized the importance of the corporation tax. The American commonwealths, finally, were the first to introduce the corporation tax, have more recently turned their attention to the inheritance tax, and have only just begun to experiment with the income tax. The differences are suggestive, but are easily explicable when we recall the economic and administrative conditions in each country. With all the variations in detail, it is clear that the democratic trend is in one general direction; and it is more than probable that progressive inheritance taxes will play by no means an insignificant rôle in the fiscal systems of the future.

NOTE TO 10TH ED. In 1922 the German *Nachlasssteuer* was abolished and the *Erbanfallsteuer* was merged into a *Reichserbschaftssteuer*, including gifts, ranging from 17½ to 70%. In the United States the federal estate tax was increased in 1924 to a maximum of 40%; and by 1922 all of the states mentioned on the preceding page as still having a proportional direct tax have, with the exception of New Mexico and Wyoming, changed to a progressive tax.

A convenient history of the British system will be found in a *Collection of Acts of the Parliament of Great Britain and of the United Kingdom of Great Britain and Ireland relating to the Death Duties . . . from the Legacy Duty of 1796 to the Government of Ireland Act,* 1914. A recent book suggesting the application of the progressive principle to that part of the estate not amassed by the decedent is E. Rignano, *The Social Significance of the Inheritance Tax,* New York, 1924.

CHAPTER VI

THE TAXATION OF CORPORATIONS

I

THE HISTORY

In a previous chapter we have considered the inadequacy and practical failure of the general property tax. In all ages and in all countries it has been found almost impossible to reach intangible personalty. What has always been a difficult task has become immensely complicated to-day through the growth of the modern corporation. At present, especially in industrial countries, the far greater part of the personalty in the hands of individuals consists of intangible property—mainly of corporate securities. The first reform of our direct taxation, therefore, is conceded by all to lie in this direction. Governments are everywhere confronted by the question, how to reach the taxable capacity of the holders of these securities, or of the associations themselves. Whom shall we tax and how shall we tax them in order to attain a substantial justice? Perhaps no question in the whole domain of fiscal science has been answered in a more unsatisfactory way. In the United States we have a chaos of practice—a complete absence of principle; in Europe, with the possible and partial exception of England, the situation is scarcely, if at all, better. Moreover, in spite of the generally recognized need of reform, there has thus far been no comprehensive attempt, from the standpoint of theory, to evolve order out of the chaos into which the whole subject is plunged.[1]

[1] A satisfactory treatment of this subject is still lacking. The English writers have paid little attention to it. *Cf.*, however, J. Bucham, *The Law relating to the Taxation of Foreign Income*, London, 1905, which deals in part with corporations. In the American literature there may be mentioned, H. G. Friedman, *The Taxation of Corporations in Massachusetts* in the Columbia *Studies*, New York, 1907; an article on the same subject by C. J. Bullock, in the *Quarterly Journal of Economics*, vol. xxi. (1907),

The first requisite in any scientific investigation of this kind is to have the facts; for without a knowledge of existing conditions, any propositions for reform would be valueless. Nevertheless, the facts of corporate taxation have never been presented in their entirety. Given the laws, it is necessary next

p. 181 *et seq.*; M. H. Hunter, *The Development of Corporate Taxation in the State of New York*, Urbana, 1917; and J. R. Moore, *Taxation of Corporations in Illinois other than Railroads since 1872*, Urbana, 1913. The studies on the different classes of corporations and on the special problems will be mentioned below in their proper place.

For the facts, see *Taxation of Corporations. Report on Systems employed in Various States. Prepared under the direction of the Industrial Commission.* By G. Clapperton, Expert Agent, Washington, 1901; and especially the monumental work in six volumes entitled *Taxation of Corporations. Report of the Commissioner of Corporations on the Systems of taxing Manufacturing, Mercantile and Transportation and Transmission Companies*, Washington, 1909-1915. This treats of the situation as of 1909, while a supplementary volume covering the interval down to 1912 appeared as a *Special Report on Taxation* in 1914. Much material will also be found in Carl C. Plehn, *Revenue Systems: State and Local Governments*, reprinted from the *Census Report on Wealth, Debt and Taxation*, Washington, 1907; and the still fuller Census volume entitled *Taxation and Revenue Systems of State and Local Governments. A Digest of Constitutional and Statutory Provisions relating to Taxation in the different States in 1912*, Washington, 1914.

In a few of the states we find special treatises on the tax law and tax legislation, devoted in whole or in part to corporate taxation. These are: J. T. Davies, *A Compilation of Constitutional Provisions, Statutes and Cases relating to the Assessment of Taxes in the State of New York*, New York, 1886, and again in 1888; John T. Merrill, *Manual of the Taxation of Corporations by the State of New York*, New York, 1897; J. H. Hammond, *Taxation of Business Corporations in New York State*, New York, 1901; H. M. Powell, *Taxation of Corporations in New York for State and Local Purposes*, Albany, 1905; the same author's *Manual of Corporate Taxation in New York for State Purposes*, New York, 1907; F. M. Eastman, *Taxation for State Purposes in Pennsylvania*, Philadelphia, 1898; the same author's *The Law of Taxation in Pennsylvania*, 2 vols., Newark, 1909; C. C. Black, *Law of Taxation with special reference to its Application in the State of New Jersey*, 2d ed., Newark, 1906; J. P. Dunn, Jr., *The New Tax Law of Indiana and the Science of Taxation*, Indianapolis, 1892; F. M. Judson, *A Treatise upon the Law and Practice of Taxation in Missouri*, Columbia, 1900; *Compilation of Tax Laws and Judicial Decisions of the State of Illinois*, made by Albert M. Kales and Elmer M. Liessmann [Springfield, 1911].

Of the general legal treatises on taxation only a few are devoted particularly to corporations. The most important is: J. H. Beale, Jr., *The Law of Foreign Corporations and Taxation of Corporations, both Foreign and Domestic*, Boston, 1904. In the ordinary treatises, however, frequent references are made to corporations. *Cf. esp.* T. M. Cooley, *Treatise on the Law of Taxation*, 3d ed., 1903; R. Desty, *The American Law of Taxation as determined in the Courts of last Resort*, St. Paul, 1884; W. H. Burroughs,

to consider the interpretation put upon them by the courts. Even then we have only the legal, not the economic view; for, unfortunately, good law is not always sound economics. It is therefore advisable to subject the legal principles involved to an analysis from the economic point of view. Only after such

A Treatise on the Law of Taxation, New York, 1877, new ed., 1883; F. M. Judson, *The Taxing Power, State and Federal, in the United States*, St. Louis, 1903. *Cf.* also the appropriate chapters in the encyclopædic works on *Corporation Law* by Cook (6th ed., 1908, 4 vols.); and by Thompson (2d ed., 1908–1910, 7 vols.).

Material on corporate taxation will be found in the histories of taxation in the various states. These are: W. M. Gouge, *Fiscal History of Texas*, 1834–1852, Philadelphia, 1852; T. K. Worthington, *Historical Sketch of the Finances of Pennsylvania*, Baltimore, 1887; W. P. Snyder, *Compendium and Brief History of Taxation in Pennsylvania*, Harrisburgh, 1906; N. W. Evans, *A History of Taxation in Ohio*, Cincinnati, 1906; E. L. Bogart, *Financial History of Ohio*, Urbana, Illinois, 1912; F. A. Wood, *History of Taxation in Vermont*, New York, 1894; M. H. Robinson, *A History of Taxation in New Hampshire*, American Economic Association, 1902; D. C. Sowers, *The Financial History of New York State*, Columbia *Studies*, 1914; S. E. Leland, *Taxation in Kentucky*, Lexington, 1920; H. S. Hannah, *A Financial History of Maryland*, Baltimore, 1907; F. H. Noble, *Taxation in Iowa: Historical Sketch, present Status and suggested Reforms*, St. Louis, 1897; J. E. Brindley, *History of Taxation in Iowa*, 2 vols., Iowa City, 1911; E. J. Benson, *Taxation in Kansas*, Baltimore, 1900; J. E. Boyle, *The Financial History of Kansas*, Madison, 1908; R. V. Phelan, *The Financial History of Wisconsin*, Madison, 1908; W. C. Fankhouser, *A Financial History of California*, Berkeley, 1913; E. T. Miller, *A Financial History of Texas*, Austin, 1916; R. Adams, *Taxation in Nevada. A History*, Carson City, 1918; *Financial History of the State of Washington*, by the Department of Efficiency, Madison, 1923. The financial histories of Jones on Connecticut, Douglas on Massachusetts, Ripley on Virginia, and Schwab on New York deal with the earlier periods, anterior to the formation of corporations.

Of the earlier German literature—and there was none in any other language—there may be mentioned: Dietzel, *Die Besteuerung der Aktiengesellschaften in Verbindung mit der Gemeindebesteuerung*, Cologne, 1859; G. S. Meili, "Rechtsgutachten über die Besteuerung von Aktiengesellschaften," in *Zeitschrift für schweizerische Gesetzgebung und Rechtspflege*, 1882, p. 489 *et seq.;* F. Hecht, "Die staatliche Besteuerung der Aktiengesellschaften in Deutschland," in *Finanz Archiv*, vol. vii. (1890), p. 37 *et seq.;* Schanz, "Die Besteuerung der Aktiengesellschaften in den deutschen Staaten," in *Wochenschrift für Aktienrecht und Bankwesen*, 1892, no. 20.

Since the first edition of this book a number of foreign studies have appeared. In German there may be mentioned D. Feitelberg, *Die Einkommensbesteuerung nicht-physischer Personen*, Jena, 1900; Wangemann, "Die Heranziehung der Aktiengesellschaften zur Gemeindeeinkommensteuer in Preussen," in *Verwaltungsarchiv*, 1901, p. 489; A. Dehlinger, "Die Besteuerung der Aktiengesellschaften in Württemberg," in *Finanz Archiv*, vol. xxi. (1904), p. 499; F. J. Neumann, "Die Aktien- und ähnliche Gesellschaften

an examination and comparison of the facts of taxation in the United States and in Europe, will it be possible to reach any conclusions that may lay claim to scientific precision. Only such conclusions, arrived at through such a method, should be made the basis for practical reforms.

This then is the program of the present series of chapters on the taxation of corporations. The great importance of having the facts accurately stated leads me at the outset, even at the risk of tediousness, to an examination of the history and of the actual conditions of such taxation in the United States, while the theory and criticism will be reserved for future consideration.[1]

I. *Early Taxation of Corporations*

During the first two decades of the nineteenth century, banks and insurance companies formed the chief examples of corporations, apart from the numerous turnpike roads and toll bridges. During the twenties and thirties the development of transportation facilities led to the creation of many canal and railway companies; and it was not long before many other forms of commercial and industrial enterprise followed in the same path of incorporation. The early tax laws made no mention of corporations. But as the general property tax was in vogue throughout all the commonwealths, it was tacitly assumed that the property of artificial as well as of natural persons was liable. Corporations were new institutions which the legislators in happy-go-lucky fashion, tried to tax under existing methods, whether they naturally belonged there or not. Our Solons had

als Rechts- und als Steuersubjekte," in *Annalen des Deutschen Reichs*, 1905, pp. 321, 418, 602; F. Dinglinger, *Die staatliche und kommunale Einkommensbesteuerung der Aktiengesellschaften in Preussen und Baden*, Berlin, 1905; L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland*, Stuttgart, 1911; E. Steinitzer, "Zur Besteuerung der Aktiengesellschaften in Oesterreich," in Conrad's *Jahrbücher*, vol. 83 (1904), p. 319; W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz*, Bern, 1906. For more recent literature see Schwarzmann, *Die kommunale Besteuerung der Aktiengesellschaften in der Schweiz*, Basel, 1919; and the work of Kaufmann and Taeschner mentioned *supra*, p. 125.

In French and Italian we may mention A. Wahl, *Traité du régime fiscal des sociétés et des valeurs mobilières*, Paris, 1909; H. Truchy, "Les valeurs mobilières et les projets de réforme fiscale," in *Revue d'économie politique*, 1909, p. 763 and 1910, p. 31; Natoli, *La personalità giuridica delle società commerciali e l'imposta di ricchezza mobile*, Rome, 1912.

[1] When the present tense is used in the following pages it refers to the conditions as they existed in 1921.

neither the leisure nor the inclination to make a more careful study of the subject.

The first commonwealth law which treated of the taxation of corporations in general was the New York law of 1823. This provided that "all incorporated companies receiving a regular income from the employment of their capital" should be considered "persons" liable to the general property tax. They were required to make returns to the county officers of all their property and their capital stock, paying the tax themselves and deducting it from the dividends of stockholders. They might, however, commute the tax by paying to the treasurers of the counties where they transacted business ten per cent on their "dividends, profits, or income," (which the legislator evidently presumed to be identical). These taxes were paid by the county officers to the state, and were then credited to the counties in proportion to the amount of stock held within each county, after deducting the state tax.

In 1825 and again in 1828 the system was slightly changed so as to conform more closely to the general property tax. The tax was made applicable to "all monied and stock corporations deriving an income or profit from their capital or otherwise." The real estate of these corporations was separately taxed; and in addition, they paid the property tax on their capital stock paid in or secured to be paid in, deducting the amount paid for real estate and the stock belonging to the state and to literary and charitable institutions. Manufacturing and turnpike companies paid on the cash value, not on the amount, of the capital stock; turnpike, bridge and canal companies, whose "net income" did not exceed five per cent of the capital stock paid in, were exempted; while manufacturing and marine insurance companies under the same conditions might commute by paying five per cent of their net income. It is thus seen that by this law corporations were divided into different classes, and that the system followed was the general property tax, with the exceptions that if a corporation had no profits it paid no tax on its stock, and that certain classes might commute by paying an income tax to the local officials. This remained the tax system, except for banks and for foreign insurance companies, until the middle of the century

In 1853 the total exemption of non-profit-paying corporations was abolished and all companies were taxed on their real estate and on their capital stock, together with their sur-

plus profits or their reserve funds in excess of ten per cent of the capital, with the same deductions as above. All corporations, however, whose profits did not equal five per cent on the capital stock might commute by paying five per cent on their "net annual profits or clear income." It seems that very few ever availed themselves of this doubtful privilege, and accordingly in 1857, the law was again changed. The principle of commutation was abandoned; and since there was no distinction between profitable and unprofitable companies, so far as personal property was concerned, all corporations were taxed on their realty and on the actual value (not the amount) of their capital stock plus the surplus profits or reserve in excess of ten per cent of the capital. In addition to the previous deductions a further abatement was made for the capital invested in taxable shares of other companies. The remainder was then taxed in the same manner as the other personalty and realty of the county. This remained the law of New York, with the exception of some special provisions as to banks and insurance companies, until the recent changes in the taxation of corporations. These changes, however, affect only taxation for state purposes, leaving the local taxation still governed by the provisions of the law of 1857. Foreign corporations, however, are taxable for local purposes, under a law of 1855, on all sums actually invested in the state.

It appears, then, that the New York system was a taxation of the real and personal property of corporations by the local assessors, and that the personal property was virtually defined as the capital stock not invested in real estate. In the other commonwealths, where corporations were taxed at all they were included in the general property tax; and most of the laws lacked even such provisions as those of the New York statute in reference to the capital stock. A typical enactment of this kind is the Connecticut law of 1826, which provided simply that the personal property of a corporation should be taxed in the place where its principal business was transacted. In Massachusetts, on the other hand, where the first general law applicable to manufacturing corporations was passed in 1832, only the real estate and machinery of corporations were taxed. In lieu of the tax on personalty there was substituted the property tax on the corporate shares in the hands of individuals, a proportionate amount being deducted from each for the part of the capital stock invested in machinery and in real estate. In

the other commonwealths, when the corporation was taxed, the shares in the hands of individuals were usually exempt. The only state which from the very outset broke with the principle of the general property tax was Pennsylvania, whose method we shall learn a little farther on.

With this one exception, then, the early principle of corporate taxation was the assessment of all real and personal property by the local officials; corporations, in other words, were taxed by the same method as individuals. This primitive system has been retained up to the present day by many commonwealths for almost all classes of corporations; and in several states, indeed, the constitutions require that corporate property be taxed in the same manner as that of individuals. The practical defects of such a system, however, have led to numerous changes in many of the progressive states, and the tendency is everywhere away from the original plan.

In a previous chapter we have seen that the shortcomings of the general property tax were five in number; inequality of assessment, failure to reach personalty, incentive to dishonesty, regressivity and double taxation. With few exceptions, these objections are as applicable to the taxation of corporations as to that of individuals. All the facts here to be recounted set the stamp of disapproval upon the original plan. In the words of a celebrated report on taxation, this method of assessing corporations locally on their general property, is "as a system, open to almost every conceivable objection." [1]

II. *Development of the Corporation Tax*

As a result of these practical defects many commonwealths have abandoned in part, or altogether, the taxation of corporate property by local officials. The movement away from this original position has taken three directions: (1) the property of transportation companies, especially railroads, has been assessed separately by a special board and according to well-defined rules; (2) certain classes of corporations, beginning with banks and insurance companies, but gradually including the so-

[1] *Taxation of Railroads and Railroad Securities.* By C. F. Adams, Jr., W. B. Williams and J. H. Oberly, a Committee appointed at a Convention of State Railroad Commissioners, to examine into and report the methods of Taxation as respects Railroads and Railroad Securities now in use in the various States of the Union, as well as in foreign countries; and further to report a plan for an Equitable and Uniform System of such Taxation, New York, 1880, p. 8.

called public-service corporations and in not a few cases other corporations, have been taxed, not on their property, but on certain elements supposed to represent roughly their taxable capacity; (3) all corporations in general have been taxed by a uniform rule, according to principles varying more or less in the different commonwealths.

The first tendency has progressed so far that there is now not a single commonwealth which applies, for both state and local purposes, the primitive method of the general property tax, locally assessed, to railroads. In 1895 there were still nine such states,[1] but in 1912 Rhode Island formed the only exception. In that year, however, Rhode Island supplemented the older system by a different method. About two-thirds of the American states [2] have broken away from the original custom so far as to have the railroad property assessed no longer by local officials, but by a state tax commission or a state board known under other and various names.[3] The tax, it is true, is usually imposed at the customary rate of the general property tax, but many of the difficulties of local assessment of property have been obviated.

In a few states the departure from the primitive system is only very slight. Thus in Louisiana although by the constitution of 1898 a state board of affairs assesses the property, corporate real estate continues to be taxed at the locality where situated and personal property at the domicile of the corporation. And in Texas, while the comptroller of state apportions the rolling stock to the counties, and a state board by a recent

[1] Louisiana, New Mexico, Oklahoma, Oregon, Rhode Island, Tennessee, Texas, Utah and Washington.

[2] Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Oklahoma, Oregon, South Dakota, Tennessee, Utah, West Virginia, Washington, Wisconsin and Wyoming. Delaware, Mississippi, Missouri, Ohio, North Carolina, North Dakota, South Carolina, Texas and Virginia, which also use this newer method, supplement it by special taxes.

[3] It is called the board of railroad commissioners in Tennessee; state board of assessors in Maine and New Jersey; state board of affairs in Louisiana; corporation commission in Virginia; board of state tax commissioners in Indiana; board of equalization in Idaho, Georgia, Montana, Nebraska, North Dakota, Oklahoma, Utah and Wyoming; and state tax commission in all the remaining states except Florida (where the assessment is put in the hand of the attorney general, comptroller and treasurer) and Texas (where it is in part entrusted to the comptroller).

law appraises the franchise, the real estate of corporations is still assessed in the old way by local officials. In most of the states, however, the policy of centralization of assessment has proceeded much farther. In some of the states which practice this so-called *ad valorem* system, the state board assesses the entire property. In others it assesses the roadbed, rolling stock and all other operative property, *i.e.* property actually used for purposes of operation, leaving the remainder of the property to be appraised by the local assessors. In still others the state board includes over and above the tangible property the value of the so-called franchise. As soon as this is done, however, a departure is made from the principles of the general property tax. For although an individual may be assessed to the property tax on his so-called intangible property, an attempt is rarely, if ever, made to assess to an individual the good will of a business. Yet a corporate franchise, as we shall see later, is in a certain sense, in part at least analogous to the good will of a business and its value as a piece of property can be reached only through a consideration of the corporate earnings. In proportion, however, as the assessment of franchises acquires greater importance, the simpler machinery of *ad valorem* assessment becomes inapplicable, and this method of taxation really merges into the one to be discussed below.

In not a few of the states which levy the *ad valorem* tax the so-called unit rule is followed. The first provision for this seems to have been made in the California constitution of 1879. By this is meant that instead of the property of the corporation being valued piecemeal, its entire value is appraised as a unit. If part of the property is without the state the property is none the less valued as a unit, and deductions are then made to compensate for that part of the property which is deemed to be without the state. In the case of railways relative mileage is usually taken as the criterion. The same rule is observed as between the various local divisions in the state, the property being assessed not by local assessors piecemeal but by a state board as a unit. The existence of the unit rule is entirely irrespective of the particular method employed to reach the value of the entire property. Sometimes only the realty and the tangible personalty of the corporation are added together; sometimes the value of the intangible personalty is added; sometimes the value of the so-called franchise is taken into account; sometimes the result is reached by ascertaining the value of

the capital stock or again of the stock plus the bonds and either with or without certain deductions. But whatever the method of ascertaining the value, the point is that the entire value of the corporation is taken as a unit.

For the reason mentioned above, as well as for others to be discussed later, this first reform of railroad taxation has not been completely satisfactory. As a consequence a number of important commonwealths have wholly or partially abandoned property as the basis of assessment.[1] The methods adopted by them are comprised in the second of the three tendencies mentioned above.

This second movement away from the property tax has consisted in subjecting particular classes of corporations to special taxes on other elements than their general property. It will be well to discuss these classes in order.

1. *Banks*

The direct taxation of banks dates back to the beginning of the nineteenth century. During the war with England the federal government imposed certain stamp duties on notes issued or discounted by banks. But this law of 1813 contained a further provision permitting the banks to compound for the duty by paying one and a half per cent on the amount of the annual dividends.

The first state law providing for a direct tax on banks was the Georgia act of 1805, which levied a tax of two and a half per cent on their capital stock and one-half of one per cent on their circulation. New Jersey followed in 1810, with a tax of one and a half per cent on the paid up capital stock of specified banks. The first Massachusetts law was the act of 1812 which imposed a tax of one-half of one per cent on the amount of their capital stock. A more important law was the Pennsylvania act of 1814, for Pennsylvania from the very outset assumed an

[1] Of these, nine states use only the new method—Connecticut, California, Delaware, Maine, Maryland, Massachusetts, Minnesota, New York and Pennsylvania. Mississippi, Ohio, North Carolina, Rhode Island, South Carolina, Tennessee, Texas and Virginia impose similar taxes in addition to the *ad valorem* system. Illinois uses the method only in the case of one railroad. Michigan, Washington, Wisconsin and Vermont at one time employed the newer method, but subsequently reverted to the *ad valorem* system. North Dakota at one time employed the new method as an alternative system until it was declared unconstitutional.

attitude different from that of the other states. According to this law, banks were taxed at the rate of six per cent upon their dividends or net profits; if exempted from the national tax, the rate was to be eight per cent. In 1824 the rate was definitely fixed at eight per cent, and a few years later the principle of graduated taxation was introduced. The act of 1835 imposed on banks of issue a tax on dividends, which varied from eight to eleven per cent as the dividends were under six or over eight per cent; and in 1840 banks were also subjected to the capital stock tax imposed on all corporations. In 1849 the dividend tax was increased. In 1850 a tax of four and a half mills on capital stock was substituted for the earlier general tax, but in 1852 this was repealed and the old tax reintroduced, which in 1859 was extended to banks of discount, deposit and savings institutions. In 1861 the progressive tax on dividends was increased so as to vary from eight per cent if the dividends were six per cent, up to thirty if the dividends were twenty-five. In 1866 a tax of one per cent was imposed on capital stock, in lieu of all other taxes on the capital stock of banks, and after some minor changes the whole system of taxing banks was replaced in 1889 by the method to be explained below.

Ohio and Virginia were the only other states which began, and for some time continued, to tax banks on dividends, although several states, like Vermont, in chartering special banks sometimes inserted a provision in the charter, reserving a portion of the profits or dividends. In Ohio a tax of four per cent on dividends was imposed in 1815, but in 1816 the general banking law obliged the banks to set aside profits which at the expiration of the charter would amount to four per cent of the total stock. In 1825 this charge was commuted into a tax of from two to four per cent on dividends, and in 1831 the rate was raised to five per cent. In 1845 banks were required to pay, in lieu of the tax on dividends, six per cent on the profits, deducting expenses and ascertained losses. Five years later the taxation of profits or dividends was abolished, and the banks were henceforth taxed at the rate of the general property tax on the amount of their capital stock and contingent fund. In Virginia the dividends tax did not begin until 1846, when the banks were required to pay one and a quarter per cent on dividends. This rate was gradually changed until during the Civil War it reached seventeen per cent. In 1870 a new system was

introduced, based partly on capital stock, partly on income or dividends above $1,500; but in the following year the present method was adopted.

While Pennsylvania and Virginia were the only commonwealths to retain dividends as the basis of taxation, a few states taxed banks on their capital stock. Thus the Massachusetts tax of 1812, changed in 1828 to a tax of one per cent on the amount of the capital stock actually paid in, remained in force practically without change until the Civil War, when the state banks were superseded by the national banks. This tax was in addition to that levied on the individual stockholders but, curiously enough, it applied only to the chartered, not to the free banks.[1] In Louisiana a tax was imposed in 1813 on the "stock in trade" of all banks; and in Kentucky a tax was levied in 1818 on the capital of the branches of the Bank of the United States. In other states, again, a special tax was levied only on the proportion of the capital stock owned by non-residents, as in the first Connecticut law of 1830, which imposed such a tax at the rate of one-third of one per cent. In most of the commonwealths, however, the special state taxation of capital stock came much later, since the principle of the property tax prevailed. When the capital stock was taxed at all, it was simply as representing the personal property, and hence it was taxable locally at the general rate of the property tax. The real estate was taxed separately, as in New York, where the personal property tax was levied on bank stock and was payable by the corporation. According to the law of 1823,[2] the tax was assessed on the par value of the stock, but in 1847 the basis was changed to the actual market value of the stock, without deduction for debts. It is worthy of note that in North Carolina, where the taxation of capital stock did not come until 1859, the rate of the tax varied with the dividends.

Since the inception of the national banking system most of the commonwealths have again changed their methods of taxing banks. The history of this change can be well traced in the legislation of New York. According to the laws mentioned above, banks were taxable on so much of their capital stock as represented their personal property. Under these acts the

[1] For a discussion of this point see W. B. Stevens, *The Taxation of State Banks*. Boston, 1865.

[2] One of the earliest discussions of the bank tax is to be found in S. M. Hopkins, *Speech on the Subject of taxing Bank Stock*. Albany, 1822.

banks claimed exemption for that part of their capital invested in United States bonds; but their claim was disallowed by the court of appeals, on the ground that no unfriendly discrimination was thereby shown to the United States as a borrower. In 1862, however, the national government provided by law for the total exemption from state taxation of all stocks, bonds and other securities of the United States. The court of appeals then held that this provision applied only to stock and bonds issued after the date of the law, but that all securities issued prior thereto were still taxable, according to the state statute. This decision was reversed by the federal Supreme Court, which held that any "stock of the United States constituting a part or the whole of the capital stock of the bank is not subject to state taxation." The legislature then sought to evade this decision by enacting that banks should be taxable "on a valuation equal to the amount of their capital stock," with similar deductions and exemptions as in the law of 1857; and the court of appeals pronounced this law valid, on the ground that the tax was on capital stock, and not on property. This decision was in turn reversed by the Supreme Court, which held the tax to be levied on the property of the bank, and therefore subject to deduction for non-taxable investments. In 1864 the national banking act was passed, which permitted the taxation of national bank shares in the hands of individuals, but not at a greater rate than other moneyed capital. This gave the New York legislature the desired opportunity, and in 1865 it enacted a law providing that all shares in national banks should be included in the valuation of the personal property of individuals. The court of appeals held this to be valid. It must be remembered, however, that the state banks were still taxed on their capital. The Supreme Court of the United States now upheld the principle of the taxability of shares, on the ground that a tax on the shares in the hands of individuals was not a tax on the capital of the bank. Nevertheless it reversed the New York decision on a minor point, namely, that since the capital of state banks invested in national securities was exempt, a tax on the capital was not equivalent to a tax on the shareholders, and hence to tax state banks on their capital and shareholders of national banks on their shares constituted a discrimination against national banks. This decision led to the New York law of 1866, which abolished the taxation of bank capital and provided for the taxation of shareholders of both

state and national banks in the same way, *i.e.*, on the value of the shares, with deductions for the capital invested in real estate. The banks were no longer taxed on their capital, but were required to retain the dividends from the stockholders until the tax was paid. The Supreme Court sustained this law, holding that no deduction should be made from the value of the shares for any part of the bank's capital which might consist of United States bonds. Later it decided the state tax on shares to be valid, even if it were collected from the banks. The question then arose whether it was competent for the shareholder to deduct the value of his debts, as was the case in the taxation of all other personal property. The court of appeals decided in 1867 in the negative, holding that there could be no deduction of debts from the assessment of bank shareholders. This case slumbered for thirteen years; but in 1880 a decision involving this precise question was reversed by the United States Supreme Court on the ground that "the prohibition against the taxation of national bank shares at a greater rate than that imposed upon other moneyed capital could not be evaded by the assessment of equal rates of taxation upon unequal valuations." The consequence was an alteration in the New York law, which now in 1880 permitted the same deductions as in all other taxable property and which provided for the assessment of shares, whether owned by residents or non-residents, at the place where the bank was located.[1]

The result of this development was that bank shareholders paid a large proportion, and in some towns the greater part,[2] of all the taxes on personal property, and that they alone were unable to evade the otherwise so laxly executed tax on personalty. A later attempt of the banks to remedy this obvious inequality was frustrated by a decision of the Supreme Court that the words "moneyed capital," in the revised statutes, are practically confined to banks and private money lenders, and that the imposition of a lower rate

[1] For contemporary views see *The State and National Banks. The Question of Taxation*, Albany, 1864; *Report of the Committee of Bank Officers of the City of New York in relation to Bank Taxation*, New York, 1875; T. J. Hillhouse, *Taxation of Banks of the State of New York*, New York, 1880; C. P. Williams, *The National Banks and State Taxation*, New York, 1887; [Seven] *Reports of the American Bankers' Association upon Bank Taxation*, New York, 1875–1889.

[2] In Albany the banks paid fifty-eight per cent of all taxes on personalty. *New York State Assessors' Report*, 1878, p. 16.

of taxation on other corporations does not invalidate the bank tax.[1]

The system of taxing banks that had been reached in New York by the close of the nineteenth century is now general throughout the United States. It may be summed up as the separate taxation of the real estate owned by the bank together with a tax paid by the bank and then withheld from dividends,[2] levied sometimes by local, but more frequently by state, officials on the value of the shares, less the value of the real estate and other exempt property. In only a few states, like Maine, Maryland, New Hampshire, New Jersey, Oregon, Texas and Vermont, is the primitive method followed of attempting to assess the shares to the owner where they reside; and even in many of these instances an exception is made in the case of national banks and of non-resident stockholders, when the tax is assessed to the bank itself. In most states the same method is applied to state and national banks. In the eyes of the law, the tax although assessed at the bank, is generally considered to be a tax on the shareholders, advanced by the bank. As a matter of fact the tax is in most cases assessed in the name of the shareholder, and has even been declared invalid if the law does not grant in specific terms the right to collect the tax again from the shareholder.[3] Practically, of course, it is not a tax on the shareholders, because of the familiar fact that new purchasers of bank shares will escape the tax through the operation of the principle of capitalization of taxation.[4]

The shares are generally taken up at market or book value; but in some cases book value is not admitted and in others, arbitrary methods of ascertaining the value are prescribed. Thus in New Jersey the assessors until recently added the capital stock, surplus and undivided profits; deducted the value of the non-taxable securities and of the real estate; and then divided the remainder by the number of shares. The result was an assessment

[1] The cases in their order are as follows: 23 N. Y. 192; 26 N. Y. 163; 2 Black, 870; 2 Wall. 200; 33 N. Y. 161; People *vs.* Weaver, 3 Wall. 573; 4 Wall. 244; 9 Wall. 353; 36 N. Y. 59; Van Allen *vs.* Assessors, 100 U. S. 539; Mercantile National Bank *vs.* New York, 129 U. S. 138.

[2] The Supreme Court has repeatedly held that the tax on the shareholder may be required to be paid by the corporation. Aberdeen Bank *vs.* Chehalis County, 166 U. S. 440; Merchants' Bank *vs.* Pennsylvania, 167 U. S. 461; Cleveland Trust Company *vs.* Lander, 184 U. S. 111.

[3] Home Savings Bank *vs.* Des Moines, 205 U. S. 503.

[4] See *infra*, chap. viii, sec. vi.

which is in few cases even approximately equal to either the market or the par value. So in Idaho by a law of 1912 the surplus and undivided profits are added to the face value of the shares and the amount of the capital invested in real estate is then deducted. In some cases again, where it is customary to assess property at only a portion of its real value, the law provides that a definite percentage of the market value of the shares be put into the assessment list. In Iowa, for instance, it is twenty per cent; in Idaho forty per cent.

In most of the states, even where the assessment of bank shares is fixed by a state official, the proceeds are distributed to the localities in which the shareholders reside. Some commonwealths have enacted more detailed provisions to avoid the confusion arising from the taxation of non-residents' stock. The Massachusetts law, for example, which dates from 1868, provides that the assessors of a town where a national bank is located shall omit from the town valuation all shares held by non-residents, and that the taxes paid by the bank on these shares shall be credited to the state.

The system sketched above is the one generally found in the United States. Since the commencement of the twentieth century, however, a number of states have substituted a special corporation tax on banks at a fixed or flat rate, in lieu of the older method. Thus in New York the law of 1901, as amended in 1903, provides for the imposition of a tax of one per cent on the value of the bank stock, which is arrived at by adding together the capital stock, surplus and undivided profits and dividing the result by the number of shares. Owing to the lower rate there is no deduction for the value of the real estate, nor is the shareholder entitled to any deduction for debts, as is the case in the general property tax.[1] The tax is payable to the county officers and is then distributed to the localities. In California a similar tax of one per cent was imposed in 1910, with the difference that the amount of the real estate locally taxable is deducted, and that the tax is payable to the state. The California tax is in lieu of all other taxes and licenses, state and local, except the local tax on real estate. In Connecticut since 1901 the banks pay to the state a tax of one per cent

[1] Since the advent of the income tax these laws have been declared unconstitutional, thus throwing the whole subject again into confusion. *Cf.* Merchants Bank *vs.* City of Richmond, 256 U. S.,635 and the makeshift legislation of 1923 in New York, imposing a tax on all monied capital.

on the market value of the shares, less the amount of the real estate, but the tax is then returned to the towns in proportion to their shareholdings. The tax on non-resident shares, however, goes to the town where the bank is located. In Pennsylvania by somewhat earlier legislation (namely, the laws of 1879 and of 1881 as amended in 1889, 1891 and 1897) the banks may pay the so-called four mills tax on the actual value of their shares or a ten mills tax on the par value of their capital stock. In the four mills tax the value of the shares is ascertained by adding together the paid in capital, surplus and undivided profits and dividing the result by the number of shares, whereupon the bank is exempted from the state tax on personal property and from local taxation on so much of its capital and profits as is not invested in real estate, but including in the exemption any bonds or mortgages whether of individuals or corporations held by them.[1] If, however, they elect to pay the ten mills tax on par value they are not relieved from the payment of the tax on mortgages. Accordingly, virtually all the banks choose the four mills tax. National banks are in any case exempt from the state tax on mortgages. A three per cent net earnings tax, changed in 1901 to a gross earnings tax, applies only to unincorporated banks without capital stock. In Delaware there is a tax of one-fifth of one per cent on the book value of the bank shares, paid to the state in lieu of all state taxes except franchise taxes; and there are also special taxes on seven of the older banks in the state. In some of the Southern commonwealths, as North Carolina and Florida, we find in addition to the tax on bank shares a license or occupation tax fixed according to the capital or the business transacted. Again, in a few states, especially in New England where it is customary to tax the deposits of savings banks, we find special taxes on bank deposits in general. So in Connecticut bank deposits are taxed in the same way as savings bank deposits, described below; and in Maine banking companies pay one-half of one per cent on average amount of interest on time deposits and deposits bearing interest of three per cent and over, deducting the value of federal, state and local bonds. In Vermont national bank deposits bearing more than two per cent interest are taxed at a special rate of three-twentieths of one per cent.

[1] This was decided in Commonwealth *vs.* Clairton Steel Co., 222 Pa. 293 (1898); and People's Savings Bank *vs.* Monongahela Consolidated C and C. Co., 29 Pa. Superior Ct. 153 (1908).

Finally there are a few cases of special taxation on foreign banks. New York, for instance, levies a tax of five per cent on the interest of moneys loaned or employed within the state, and Maine taxes the branches of foreign banks at the rate of three-quarters of one per cent on the amount of business transacted within the state. California, on the other hand, taxes branches or agencies of foreign banks on their capital employed within the state at the same rate as domestic banks; while some states like Idaho tax foreign banks at the ordinary rate on the general average of moneys used.

Since the advent of trust companies, the bank tax has frequently been extended to them, as in New York, In other states as in many of the New England commonwealths, loan and trust companies are taxed like savings banks, rather than like banks in general. In other cases again, as in California, the same methods apply to banks, savings banks, and loan and trust companies. Occasionally also, as in Idaho, surety and fidelity companies are included in the system of bank taxation.

There remains the subject of savings banks. These, when incorporated, as is usually the case in the western states, are taxable in the same way as banks proper. This is true also in Pennsylvania, even when they are not incorporated, for in that state they pay the same special taxes as banks in general. In New York they are taxable only on surplus. In New England, however, the custom is, and has for a long time been, to tax savings banks, which are almost always unincorporated, on their deposits. In Massachusetts, where up to that time, the deposits had been nominally taxable as the personal property of the individual depositors, the new system came into use in 1862; in Vermont, not until 1878; in the rest of New England, in the interval. The rate of tax is, however, in every case far below that on property in general; [1] and it is customary to allow various deductions. Thus in Massachusetts the rate is one-half of one per cent on deposits, less the amount invested in taxable real estate, mortgages and state bonds. In New Hampshire the rate is three-quarters of one per cent on deposits, deducting the amount invested in real estate, mortgages bearing not more than five per cent interest, and state and local bonds. In the case of special deposits, however, the rate is one per cent. In Vermont there is a tax of seven-tenths of one per cent on the deposits and

[1] *Cf.* in general W. G. Abbott, *Objections to the Taxation of Savings Banks.* New York, 1880.

accumulations less the amount invested in real estate or in federal bonds (if not more than ten per cent of the assets), and excluding also individual deposits over $2,000, provided these are listed to the depositors where they reside.[1] In Maine a tax of five-eighths of one per cent is imposed on the deposits, reserve fund and undivided profits, with deductions for the assessed value of real estate, the amount invested in federal bonds or in shares of corporate stock which are tax-free to stockholders by law, and deducting also two-fifths of any other assets which are invested in the state. In Connecticut there is a tax of one-quarter of one per cent on deposits exclusive of the surplus over $50,000 and over the amount invested in real estate, in state or local bonds issued to aid railway construction or in the stock of banks, trust, insurance, investment and bridge companies. In Rhode Island the tax is at the rate of four-tenths of one per cent on deposits and undivided profits.

Outside of New England the tax on savings banks deposits is found only in Maryland where the franchise tax on savings banks amounts to one-quarter of one per cent on the deposits, three-fourths of the tax going to the place where the bank is located, and one-fourth going to the state. In many states outside of New England, however, deposits in savings banks are nominally taxable to the owner as part of his personal property. In New York, however, such deposits are exempt by statute.

In the matter of bank taxation, therefore, we are beginning to reach uniformity, with the exception of savings banks in the New England states. Two points are especially to be emphasized in the present situation. One is that bank taxation has been comparatively successful in proportion as we have attempted to apply to the property tax what in the case of the income tax is usually called the stoppage-at-source system. That is, not the income receiver, or in this case not the owner of the property, is taxed, but the corporation which pays out the income or which, in this case, represents the owner of the property and deducts the tax from the income of the property. The second point is that the uniformity which has been attained has been to a large extent imposed upon the states by national law. Were it not for the existence of the national banks and the provision of the national banking law of 1864 as to equal taxation, men-

[1] Deposits under $2,000 are exempt from any taxation.

tioned above, the system of taxation of banks in general would probably be as little satisfactory as is at present the taxation of other intangible property. The real progress that has been made is the result of federal pressure, not in the sense of deciding what must be done, as in Germany or Switzerland, but in the sense of affirming what cannot be done. The mere fact of a national prohibition has sufficed to bring order into the state systems. This is a lesson which has not yet been learned in most of the other corporation taxes with which we shall have to deal.

2. *Insurance Companies*

The next corporations to break away from the general property tax were the insurance companies. At first only foreign companies [1] were taxed. The earliest law was that of 1824 in New York, which provided that foreign fire insurance companies should pay ten per cent on all premiums for property insured within the state. In 1829 the law was extended to foreign marine insurance companies, and in 1837 the rate was reduced to two per cent. Domestic companies were taxable on their capital stock, like all other corporations, according to the general law of 1828. Ohio started out by taxing insurance companies as well as banks, assessing them in 1830 four per cent on their dividends. But this form of taxation was soon abandoned. In Pennsylvania, where domestic companies were included in the general law of 1840, foreign insurance companies were not specially taxed until 1849, when the law imposed a tax of one per cent on the gross premiums of foreign life insurance companies. In Maryland the custom dates from 1839, when a tax of two per cent was imposed on the premiums received by the agents of foreign insurance companies. In Vermont foreign fire insurance companies were taxed eight per cent on their premiums in 1825; but the law was repealed five years later. In Massachusetts where domestic fire and marine insurance companies were first taxed in 1862, and domestic life insurance companies not until 1880, a tax on foreign companies was first levied by the law of 1832, which is of special interest

[1] The use of the term *foreign corporations* in the American statutes is confusing. Generally it designates companies incorporated in another of the American commonwealths. In only a few cases does it refer to non-American states. In these chapters it will be used in the former sense unless otherwise indicated.

as the prototype of what is known in several of our commonwealths to-day as the "reciprocal acts." The act provided that if any commonwealth taxed the agents of Massachusetts insurance companies, the insurance companies of such commonwealth were to pay one-half of one per cent on the whole amount insured by such companies in Massachusetts. At present the reciprocal acts go somewhat further and prescribe that foreign insurance companies are to be taxed at the same rate (if higher than the home rate) that is imposed on home insurance companies by the commonwealth chartering the foreign company. Such reciprocal acts are found in over two-thirds of the American states; and in a few states like Connecticut, Illinois and New Jersey they still constitute the only form of taxation of foreign insurance companies. The Kansas court calls them "an appeal for comity," "a demand for equality;" [1] but in reality they are retaliatory, rather than reciprocity, laws,[2] and are even so called in some of the states.

This premiums tax on foreign companies was gradually extended to domestic companies, until at present it is found in almost every commonwealth, only a few of the Western states clinging to the original custom of taxing them on their property. Occasionally the tax is known as an insurance license or an insurance fee. In some of the Southern states the companies must pay both fees and taxes. In most cases the laws apply to all kinds of insurance companies, of which the chief examples are fire and life insurance companies. In several states casualty companies are included and in a few states others as well are specifically mentioned, such as plate glass, indemnity, accident, surety, fidelity and employers' liability companies in Florida; plate glass and boiler insurance companies in North Carolina; river, security and indemnity companies in Louisiana; live stock, plate glass, lightning and tornado companies in Mississippi; storm and lightning companies in Texas; and marine companies in quite a number of states. The taxes are in general the same on the various classes, although not infrequently somewhat lower rates are imposed on life insurance, and especially mutual companies. Yet in a very few cases the reverse is true. Thus in Louisiana the graded tax rises to $4,500 in the case of fire insurance companies, but to $5,250 in the case of

[1] *Cf.* 29 Kan. 672.

[2] Alabama declared them unconstitutional for this reason; 60 Ala. 217. In the other states they have been upheld.

life insurance companies; and in Texas life insurance companies may be taxed up to 3% on premiums, other companies only ½ of 1%. These are, however, exceptions to the general rule. Fire and life insurance companies, again, are usually taxed not only at the same rate but in the same manner. Yet exceptions to this rule are occasionally found. In Pennsylvania, for instance where fire and marine companies pay three mills per dollar of capital stock, life companies (except mutual) pay on gross premiums. In New Jersey insurance companies, other than life, are taxed one per cent on premiums, while domestic life insurance companies pay one per cent on their surplus plus thirty-five hundredths of one per cent on their premiums; but the payments from the foreign companies are credited to the domestic companies. New Jersey, however, is one of the very few states where the (net) assets of domestic life insurance companies are in addition subject to local taxation.

On the other hand, it is customary to make a distinction between domestic and foreign companies. In nine states [1] domestic life insurance companies are not taxed at all, while foreign companies pay on gross receipts or, as in Nevada, are subjected to a license tax. In six states, domestic life insurance companies are taxed at a lower rate than foreign companies—Alabama 1% as against 2%, Iowa 1% as against 2½%, Mississippi 2¼% as against 2½%, Pennsylvania 8 per mill as against 2%, South Dakota 2% as against 2½%, and Tennessee 1½% as against 2½%. Yet in a few cases the situation is the reverse. Thus in Maine foreign life insurance companies pay 1½% on gross receipts, while domestic companies pay not only 2%, but in addition a tax on surplus after deducting the value of the real estate owned in the commonwealth. So in Vermont while all insurance companies pay 2% on premiums, domestic life, fire and casualty insurance companies pay in addition 1% on the surplus above the necessary reserve of 4%, although with a deduction for the real estate locally taxed. In Wisconsin foreign life companies pay a license fee of $300, but domestic companies are subject to a tax on gross receipts. Here, however, as in not a few of the other states the retaliatory law is in force. In some states, again, like Rhode Island, mutual insurance companies are taxed at a lower rate than others. New York takes perhaps the palm in the matter of complexity of rate

[1] Indiana, Kansas, Kentucky, Maryland, Nevada, North Dakota, Oklahoma, South Carolina and West Virginia.

of insurance taxation. Life insurance companies, whether domestic or of any other American state, pay one per cent on premiums, while life insurance, health and casualty companies of foreign countries pay under the insurance law two per cent. On the other hand, while domestic fire and marine insurance companies pay one per cent on premiums, similar companies of other American states pay two per cent, and similar companies of foreign countries pay one-half of one per cent to the state treasurer and in addition two per cent to the local fire department or superintendent of insurance respectively. In addition all foreign companies are subject to the retaliatory tax.

In some states, again, foreign and domestic companies are taxed on a different basis. Thus in Delaware, District of Columbia, Michigan, Missouri, Ohio and Oregon, foreign companies are taxed on their premium receipts while domestic companies are taxed on either surplus or net premiums. Finally in Connecticut, Illinois and New Jersey foreign life companies are taxed only by reciprocal laws, while domestic companies are taxed either on assets or on surplus.

Although the premiums tax is the general tax we find not a few cases where the tax is based on a different element. Some of the Southern states impose license or privilege taxes of a fixed amount, frequently in addition to the tax on premiums. In North Carolina insurance companies pay licenses from ten to two hundred and fifty dollars together with a tax of 2½% on gross receipts; in Florida from fifty to two hundred dollars together with a tax of 2% on gross receipts. In Mississippi they pay both fixed licenses and taxes on premiums, but the latter tax is not imposed when the *ad valorem* tax is levied. In Louisiana life and accident insurance companies pay a fixed license tax based on gross premiums, divided into 69 classes, the tax being graded from $150 to $5,250. In Illinois, Michigan, Missouri and Ohio, the tax on domestic life insurance companies is imposed on surplus. In Connecticut the tax is imposed on assets at the rate of ¼ of 1%. In Wisconsin the tax on domestic life companies is at the rate of 3% on gross income excepting that derived from the rents of real estate, and excepting also premiums collected outside of the state on policies held by non-residents.

Other states combine various taxes. Thus Maine levies on domestic life insurance companies a tax of 2% on gross receipts in addition to a tax of ½ of 1% on surplus after deducting the

value of the real estate owned within the commonwealth. Massachusetts imposes on life insurance companies a tax of 2½ mills on each dollar of insurance, as compensation for the state valuation of policies and an excise tax of ¼ of 1% on the net value of all policies in force. Other domestic insurance companies, including fire, marine, and real estate title companies, pay an excise tax of one per cent on premiums and assessments; while foreign companies pay two per cent, or as much more as is necessary according to the retaliatory law—which law applies also to life insurance companies. Non-American companies pay four per cent on premiums (or two per cent if there is a guarantee fund of $200,000), while non-American accident, fidelity and guarantee companies pay two per cent. It need scarcely be added that when the reciprocal law is in force, as in New York and Massachusetts, there is a highly diversified system of insurance taxation.

The tax on premiums is generally levied on gross premiums or gross receipts. In only a few states, as in Montana, Nebraska, New Mexico and Oklahoma is the tax levied on net receipts. In Illinois, however, the net receipts of foreign insurance companies are entered as personal property, and are included in the general property tax; whereupon the companies are then free of all local taxes, except for the benefit of the fire departments which may impose a tax not exceeding two per cent on gross receipts. In many states where the tax is imposed on gross premiums certain deductions are made. Thus in the case of fire companies return premiums and reinsurance premiums are deducted in eleven states,[1] and losses and return premiums in a few others. In the case of life insurance companies the deductions are more diversified. In Indiana losses are deducted; in Oklahoma, South Carolina, Vermont and Washington dividends are deducted; in Idaho losses and dividends; in Arkansas losses and commissions; in Maine dividends to domestic policy holders only; in Mississippi death claims, matured endowments and cash dividends paid under contracts in the state; in Iowa losses, matured endowments, dividends, increase in reserve and amounts paid in cancelled policies; and in Utah the property tax paid on any real or personal property. Moreover, it has been decided in many states including Kentucky, Louisiana, Minnesota, Nebraska, New York, Pennsylvania

[1] Georgia, Kentucky, Maine, Michigan, New Hampshire, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia and Wisconsin.

and Tennessee, either by the courts or by the administrative authorities, that the words "gross premiums" or "premiums received" do not mean the premiums stipulated for, but that the so-called rebates or dividends paid to policy holders should be deducted, as they diminish to that extent the premiums actually received by the companies.[1]

The rates of taxation are now exceedingly varied, being from ½ of 1% to 3% in the case of life insurance companies, and from ½ of 1% to 3½% in the case of fire insurance and other companies. In the case of life insurance companies the rates have tended to increase during the past few decades. Toward the middle of the eighties of the last century the average rate in all the states was a little over one per cent on gross premiums. By 1892 the average had risen to one and a half per cent. By the end of the century it was over two per cent, and at present it is still higher—about 2.08 per cent.[2] It must be remembered further that insurance companies are in almost all cases also taxable locally for their real estate, and that six states, chiefly in the south, permit the counties or municipalities or both to levy additional taxes on premiums;[3] while not a few of the Southern states like Florida levy in addition fixed licenses, state or local or both.

The growing burdens on life insurance have led in recent years to a discussion as to their propriety. In view of this and of the further fact that life insurance companies differ in important respects from the other corporations treated in these chapters we shall depart from the general order of treatment and discuss briefly in this place the principle involved.

On the one hand it is claimed that life insurance companies, or at least mutual life insurance companies, should not be taxed at all. For such companies it is said, are not profit-making organizations. A tax on them is really a tax on the policy holders, and thus in effect a tax on thrift and foresight, constituting an interference with a socially most commendable

[1] A full account of the law and practice on this point will be found in the *Memorandum on Interpretation of Secs. 65 and 73 of Chap. 77, Acts of 1907 of the State of West Viriginia relating to the Tax on the Premiums of Life Insurance Companies.* By Alfred Hurrell, Attorney of the Association of Life Insurance Presidents. [1910.]

[2] *Cf.* J. F. Dryden, *Taxation of Life Insurance Companies in the United States.* An Address, New York, 1908, pp. 11–12

[3] These are Alabama, Georgia, Kentucky, Montana, South Carolina and Virginia.

and beneficent practice.[1] Other writers do not go quite so far as this, but make a plea for great leniency of treatment and suggest that a tax be imposed in the nature of a license fee for the privilege of doing business, the amount of the tax to be restricted to a sum just sufficient to cover the necessary cost of supervision. For life insurance companies, according to these authors, enjoy no special privilege, but constitute primarily a means of co-operation to distribute the cost of providing for dependent widows and children and of saving a fund for old age.[2]

To this view, however, several objections may be urged. In the first place, modern life insurance companies are often utilized, in part at least, to afford a safe means of investment as well as insurance against death. Why, it may be asked, should such investments be treated more tenderly than others. But, secondly, there is a broader ground for dissent from the claim for great leniency. The demand that the amount of the tax should be put in some relation to the cost of supervision is untenable because the modern basis of taxation, as we know, is not benefits received or the cost of the advantage conferred, but ability to pay. While it is indeed true that public-service corporations which enjoy special privileges may reasonably be asked to pay a special tax because these privileges enhance

[1] The fullest statement of this position will be found in Willard Morrill, *Taxation of Life Insurance Companies. Argument before the Wisconsin Tax Commission at Madison, Oct. 2, 1900*, esp. pp. 3–11, 41. See also a monograph bearing the same title by Charles E. Dyer, giving the argument submitted on Oct. 23d, 1900. For a more recent statement see Robert Lynn Cox, *The Impropriety of taxing Returns to Life Insurance Policy Holders*, Boston, 1909, pp. 5–6. *Cf.* the addresses at the Tax Conference held in New York in Dec., 1908, under the auspices of the Association of Life Insurance Presidents; and the *Proceedings of the Annual Meetings of the Association* [six to 1912].

[2] This view is emphasized in the "Report of the Committee on Uniform Insurance Taxation" in the *Addresses and Proceedings of the Fourth Conference of the International Tax Association*, Columbus, 1911, pp. 291–294. A plea for leniency is also made by S. S. Huebner, "The Taxation of Life and Fire Insurance Companies" in *ibid., First Conference*, New York, 1908, p. 595. *Cf.* also *Injustice and Inequality of Life Insurance Taxation. Report of Committee adopted by National Convention of Insurance Commissioners at Detroit on August 24, 1908;* E. E. Rittenhouse, *Taxation of Insurance Premiums, An Address*, Atlantic City, 1908; J. A. De Boer, *Taxation of Level Premium Life Insurance*, 1909; and the chapters devoted to taxation in F. L. Hoffmann, *Insurance Science and Economics*, New York, 1911.

their ability to contribute to the common burdens, the absence of special privilege does not justify exemption or remission from ordinary taxation, whether in the case of corporations or in that of individuals. Moreover, the mere fact that the property or the income on which the tax is imposed is the result of thrift or foresight cannot be regarded as constituting a valid objection. As long as the general test of ability to pay is found in property, as in the United States, or in income, as in Europe, it is impracticable to avoid the taxation of thrift or of any of the other qualities which are responsible for the accumulation of capital or the enjoyment of income. For all capital is the result of saving. To abandon the taxation of life insurance savings would logically lead to the abandonment of all taxes on savings in general, and that would be tantamount to the taxation of expenditure which, as we know,[1] represents a bygone stage in the evolution of fiscal policy. As it has been well put:

> "This system of taxing savings and accumulated wealth has been deliberately adopted and will not be abandoned. The civilized nations of the world have committed themselves to the general policy of levying taxes, so far as possible, in proportion to ability, not disability; according to strength, not weakness; and as the thrifty man is usually the able and the strong man, he will continue to pay most of the taxes. One of the incidental disadvantages of this ability principle is the fact that it does to a degree tend to discourage thrift. But you cannot build a system on incidentals. The proposal to build a system of taxation on sumptuary principles—penalizing waste and thriftlessness, rewarding thrift and industry—has been repeatedly made in the past and deliberately rejected. It is impracticable, for one thing, because the more it succeeds, the less revenue it yields." [2]

On the other hand, it is equally true that life insurance companies should not be subjected to an exceptionally high rate of taxation. Owing to the ease with which they can be reached, it has become customary in the United States to put them almost on a plane with public-service corporations, and virtually to tax the capital invested in insurance policies at a

[1] *Cf. supra*, pp. 8–10.

[2] T. S. Adams, *Some Obstacles which delay the Reform of Life Insurance Taxation. An Address delivered at the Fourth Annual Meeting of the Association of Life Insurance Presidents*, Chicago, 1910, pp. 6–7 of reprint. *Cf.* also Lester F. Zartman, *Investments of Life Insurance Companies*, New York, 1906, and the same author's *Necessity for Reform in Life Insurance Taxation, An Address delivered at the second Annual Meeting of the Association of Life Insurance Presidents*, New York 1908, pp. 3–5 of reprint.

considerably higher rate than other intangible property, most of which in fact practically escapes taxation. Not only are life insurance investments taxed more severely than others, but life insurance companies in the United States are taxed at a higher rate than anywhere else in the civilized world.[1]

Moreover, the life insurance companies have undoubtedly a just ground of complaint in the heterogeneity of burdens to which they are subjected.[2] The evils of unequal and double taxation, which as we have seen above[3] are great enough in general in the United States, are accentuated in this case by the remarkable decision of the Supreme Court that the business of life insurance does not constitute commerce and is therefore not subject to the restrictions governing the state taxation of inter-state commerce.

When we come to the question as to the basis on which life insurance companies should be taxed, it is not altogether easy to reach a decision. Some authorities recommend the taxation of assets or of the income from assets.[4] This is, however, impracticable in most of the commonwealths because a large part of the insurance is written by foreign companies whose assets it is impossible to reach. It is largely for this reason that most of the states have had recourse to the taxation of gross premium receipts within the state. In principle, however, this is open to serious objection, for very much the same reason that taxes on gross receipts in general are lacking in equity.[5]

In addition to this general objection it may be observed that a system of taxation of premium receipts is not especially well suited, in theory at least, to a community which still continues to tax property as such. For premium receipts bear comparatively little relation to assets. Companies carrying

[1] In Germany, for instance, with an annual premium income of over 120 million dollars, life insurance companies paid in taxes of all kinds in 1907 only about $300,000, or less than one-quarter of one per cent of the premium income as over against the two per cent and more, which is the average in America. *Cf.* J. F. Dryden, *Taxation of Life Insurance Companies in the United States*, 1908, p. 10.

[2] *Cf.* W. J. Graham, *Life Insurance Taxation. An Address before the North Dakota Tax Association.* Grand Forks [1910].

[3] *Supra*, chap. iv.

[4] This is the view of the Wisconsin Tax Commission in its Report for 1911, and is also upheld by G. H. Noyes, *Life Insurance Taxation. Report and Bill of the Wisconsin Tax Commission, with other Facts* (1911).

[5] *Infra*, chap. vii, sec. ii.

large amounts of so-called industrial insurance collect much larger amounts in premiums in proportion to reserve assets required to meet the obligation of those contracts than in the case of the usual type of policy. The same disproportion is to be found in companies which have a large amount of paid-up and well-matured policies in force as compared with other companies.[1]

If premium receipts at all are nevertheless utilized, it should be as far as possible net, rather than gross, premiums on which the tax is imposed. That is to say, the companies should be permitted to deduct from the gross premium receipts all moneys paid back during the year by way of death losses, surrender values, endowments, *etc.*, as well as for expenses of the local agency organizations.[2] In this way we should at least get a little closer to the relative taxable ability of the various companies. It is, however, not likely that any immediate change will be made in the policy of the American commonwealths, which are predisposed to the simpler administrative methods and which naturally prefer ease and certainty of assessment to the more ideal ends of abstract justice. As long as this feeling prevails, perhaps the most practicable plan still remains that of a fairly low, but uniform tax on gross receipts. But this, it must not be forgotten, is only a relatively satisfactory solution.

3. *Railroads*

(*a*) *History*

A complete history of the development of railway taxation would occupy an entire book. It will be possible here to say only a few words about some of the typical commonwealths.[3]

[1] *Cf.* George Curtis, Jr., *Life Insurance Taxation, An Address*, 1911. This is incorporated with a few changes, in the *Report of the Wisconsin Tax Commission* for 1910, chap. 5.

[2] This suggestion is forcibly urged by Robert Lynn Cox, *Taxation of Life Insurance in the United States, A Reprint from the Addresses and Proceedings of the Second International Conference on State and Local Taxation.* Columbus, 1908, pp. 14–15.

[3] There is no general history of railway taxation in the United States. For the period from 1890 to 1902, however, we now have the admirable compilation by the Interstate Commerce Commission entitled *Railways in the United States in 1902. A Twenty-two Year Review of Railway Operations; a Forty-Year Review of Changes in Freight Tariffs; a Fifteen-Year Review of*

In Pennsylvania, railroads were included in the general tax law of 1840, and were assessed on their personalty and on their dividends. In 1844 the tax on personalty was abandoned, but the general corporation tax on capital and dividends continued with some modifications. In 1861 a special tonnage tax was levied on transportation companies at the rate of two, three and five cents per ton of freight carried, and an additional tax of three-quarters of one per cent was laid on their gross receipts. The former was declared unconstitutional by the federal courts, and as a result, by the act of 1874, both the tonnage tax and the gross receipts tax were abandoned. For the old tonnage tax there was now substituted a tax of three cents a ton on the number of tons of coal mined or purchased by the companies engaged in mining, purchasing or selling coal. This tax, however, ceased in 1881, after having been declared unconstitutional, because it applied to interstate tonnage, notwithstanding the fact that it was a tax on franchise, and not on business. In 1877 the gross earnings tax was reimposed at the rate of eight-tenths of one per cent and with slight amendments in 1879 and 1889 is still in force. In 1879 a law was passed imposing a tax on the capital stock of corporations in general, which with some amendments is in force to-day.[1] In the meantime railroads were subjected to the tax on loans which was first imposed in 1864. In 1868 an attempt was made to extend this tax to securities held by non-residents, but the act was declared unconstitutional, as was a later act of a similar nature in 1881. It was not until 1885 that an effective tax on corporate loans, now in force, was introduced.

In New York, railroads were subject to the general property tax until 1880, when a law was enacted substituting for state purposes a tax on the capital stock of corporations in general, which will be discussed later in detail[2] and which with some modifications is still in force. In 1881 an additional annual "franchise tax" was imposed at the rate of one-half of one per cent on the gross earnings of all transportation and transmission companies. In 1886 the organization tax was imposed on all

Federal Railway Regulation; a Twelve-Year Review of State Railway Regulation; and a Twelve-Year Review of State Railway Taxation, Washington, 1903. *Cf.* W. O. Hedrick, *History of Railroad Taxation in Michigan*, Lansing, 1912; and G. E. Snider, *The Taxation of Gross Receipts in Wisconsin*, American Economic Association, 1906.

[1] *Cf. infra*, p. 197.

[2] *Infra*, pp. 200 *et seq.*

corporations in general and in 1895 the license tax on foreign corporations. Finally in 1899 the special franchise tax, to be explained later, was introduced. All these laws are, with some modifications still in force.

In Connecticut, the law requiring certain stock companies to make returns of the stock owned by individuals was extended in 1846 to railroads. Three years later every railroad that had paid a dividend in the preceding year was required to pay one-half of one per cent on the market value of the shares held by non-residents; but if the railroad was partly out of the state, the tax was to be proportioned to the mileage in the state. This system worked so well that in 1850 it was extended to resident stockholders, and was made one-third of one per cent in lieu of all other taxes. In 1862 the rate was increased, but the provision was inserted that the stock should not be assessed at less than ten per cent of the par value. In 1864 the outlines of the present system were drawn by requiring the companies to add to the valuation of the stock the market value of the funded and floating indebtedness less the cash on hand, and to pay one per cent on this valuation in proportion to the mileage in the state. In 1871 it was provided that if the railroad paid any local tax this might be deducted from the state tax. In 1881 a deduction was made from the taxable valuation for such portion of its debt as was contracted for stock taken in other roads. In 1882 the funded and floating debts and bonds were to be valued at par unless the market value was below par. In 1915, however, the system was changed to the taxation of gross earnings and the present law was enacted.

In Vermont the attempt to break away from the older methods came in 1882, when a graded gross receipts tax was imposed. On gross receipts up to $2,000 a mile the rate was 2%; on the first $1,000, or part thereof, above $2,000 the rate was 3%; on the first $1,000, or part thereof, above $3,000 the rate was 4%; and above $4,000 the rate was 5%. This law, however, was declared unconstitutional in 1890 by the state court as an interference with interstate commerce and was supplanted by the law of the same year, which, with a few modifications, is still in force and which provided for an alternative system—either a tax on gross receipts or a tax on the so-called appraisal, which is nothing but an *ad valorem* tax, including the value of the franchise, although at a fixed rate. The tax on appraisal was fixed at 7/10 of 1% in 1890, was increased to 1% in 1902,

and to 1¼% in 1908. The gross receipts tax was fixed at 2½% in 1890 and in 1906 a graded tax of from 2½ to 4% was introduced. In 1912, however, the gross earning tax was abolished.

In Maine, a graded gross earnings tax was imposed in 1881. The rates were ¼ of 1% on gross earnings up to $2,250 a mile; ½ of 1% on earnings from $2,250 to $3,000; and then increasing by ¼ of 1% for every $750 until the rate reached 3¼%. In 1893 the rates were altered by providing that on earnings of $1,500, or under, the rate should be ¼ of 1%, thence increasing by ½ of 1% for every $750 until the rate reached 3¼%. In 1907 the maximum reached 4½% and in 1911 the rates were further increased and the scale now in force was instituted.

In Maryland the gross receipts tax was first imposed in 1888 at the rate of ½ of 1%. In 1890, the rate was increased to 1%, and the tax was made applicable to foreign as well as domestic railways. In 1896 the tax was graduated, being $^8/_{10}$ of 1% on the first $1,000 per mile of gross earnings; 1½% on earnings from $1,000 to $2,000 per mile; and 2% on all earnings over $2,000 per mile. In 1906 the rates were increased and the scale now in force was adopted.

Of the other Eastern states to break away from the primitive system New Jersey has had an especially interesting history partly because it still favors a variation of the *ad valorem* system, partly because its peculiar situation has enabled it to grapple more successfully with the problem of the adjustment of state and local taxation. For New Jersey is economically only an adjunct to the city of New York. A small state, with a population far inferior to that of the neighboring metropolis across the river, and with correspondingly insignificant state expenses, New Jersey is traversed by some of the most important railway lines in the country and contains what are practically the New York city terminals. From an early period, therefore, the railway tax question assumed an importance which was not realized until much later in other states. In New Jersey railroads were at first subject to special taxes as fixed in their separate charters. In 1851, however, they were subjected to the general property tax system. In 1873 came the break. A tax was now imposed at the rate of one-half of one per cent on a valuation equal to their cost, equipment and appendages, and the assessment was put into the hands of a state official known as the state commissioner of railroad taxation. Three years later, as the result of a constitutional amendment of 1875 the cost tax was aban-

doned and a tax at the same rate was imposed on the "true value" of the road and equipment, which was now to be estimated by a board of railway commissioners. In 1884 a new and more elaborate system was adopted. A state board of assessors was created to value all railway property used for railway purposes, the non-operative real estate being still assessed locally like other ordinary realty. The property was divided into four parts, viz.: (1) the so-called main stem, consisting of the roadbed, not exceeding one hundred feet in width, and the railroad stations; (2) the rest of the real estate used for operation, ordinarily described as the second-class property; (3) the tangible personalty of the railway; and (4) the franchise. It was this last category which, as we shall see later, was the important innovation, and which constituted the real departure from the system of property taxation. On the entire valuation, as fixed by the board, a tax of one-half of one per cent was imposed for state purposes. In addition to this tax, the so-called second-class property was to be taxed at the general local rate (not to exceed one per cent), and the revenue from this additional tax was to go to the localities. This remained the system until 1897 when the state relinquished to the localities the entire tax on second-class property, reserving to itself only the tax on the main stem, the personal property and the franchise. In 1906, however, the tax rate on these three categories was considerably increased, railroad stations which had hitherto been included in the main stem were now placed in the second class property subject to local taxation, and the present system was put into force.

Leaving the states of the Atlantic seaboard we come next to Ohio. Ohio retained the old system as the exclusive method until 1896. In that year, however, Ohio added a so-called excise tax of ½ of 1% on gross receipts for state purposes, which was increased in 1902 to 1%. The *ad valorem* system, however, was also continued. The same double system has been perpetuated by the law of 1910, still in force, which increased the tax on gross earnings (now limited strictly to intra-state earnings) and which at the same time confided the assessment of railway property to a state board.

Of the states further west the break with the old methods had come earlier. In Michigan a tax on gross receipts was first imposed in 1873 at the rate of 4% or 2%, according as receipts were over $4,000 or not, although a few of the most im-

portant railroads in the state were subject to special taxation as fixed in the original charter provisions. In 1891 the general tax on gross receipts was graded according to the following scale: for the first $2,000 gross receipts per mile the rate was 2%; from $2,000 to $4,000, 2½%; from $4,000 to $6,000, 3%; from $6,000 to $8,000 3½%; over $8,000, 4%. In 1897 the scale was increased, the stages remaining the same, but the rates being respectively 2½%, 3¼%, 4% and 5%, with the further addition that the gross income of all union railroad station and depot companies whose earnings were over $20,000 a mile should pay 10% on the excess gross incomes over that amount. In 1899, however, for reasons to be discussed later, the gross receipts tax was abolished and the *ad valorem* system reintroduced. This law was declared unconstitutional, whereupon the constitution was amended in 1900; and in 1901 the *ad valorem* system was reinstituted by a law still in force, the valuation to be entrusted to a state tax commission.

What happened in Michigan took place also in Wisconsin. Wisconsin's experiment with the taxation of gross receipts began considerably earlier—namely, as far back as 1854, when a tax at the rate of 1% was imposed. After some trouble with this, the tax was changed to a license fee on gross earnings, at the same rate, and in 1862 the rate was increased to 3%. In 1871 a special rate of 5% was imposed on railways indebted to municipalities, *etc.* In 1874, the general rate was increased to 4%, and in 1876 a graduated scale was introduced. The so-called license fees were now fixed as follows: for receipts of less than $1,500 per mile the tax was $5 per mile; from $1,500 to $3,000, $5 per mile plus 2% on earnings in excess of $1,500; for receipts of $3,000 and over, 4%. But all railroads upon pile or pontoon bridges were taxed uniformly at the rate of 2%. In 1897 the scale was revised as follows: for receipts of less than $1,500 per mile, the tax remained at $5 per mile; from $1,500 to $2,000, the tax was $5 per mile plus 2½% on the excess earnings over $1,500; from $2,000 to $2,500, the rate was 3%; from $2,500 to $3,000, 3½%; above $3,000, 4%. The same provision as before governed pile and pontoon railroads. In 1903, however, largely for the same reasons as in Michigan, the gross receipts system was abandoned and was replaced by the *ad valorem* method, under strict state assessment.

While Michigan and Wisconsin have abandoned the gross receipts method, Minnesota has retained it and California,

after a careful study of the problem has recently introduced it. In Minnesota the system until 1873 was that of the old general property tax. In that year it was provided that railways might commute for the property tax by the payment of a tax on gross earnings. In 1887 the gross earnings tax was made obligatory: for the first three years of operation, the rate was 1%, for the next seven years, 2%, thereafter, 3%. In 1903, however, a flat rate of 4% was introduced, increased in 1913 to 5%. When California adopted a similar system in 1910, the same rate of 4% was applied, increased in 1915 to 5¼% and in 1921 to 7%. The only other Western state to employ the gross receipts method was North Dakota, which introduced the system in 1883, the rates being graded according to the age of the road. In 1889, however, the roads were given the alternative of paying a tax on property or on gross earnings. But in 1891 the gross earnings law was declared unconstitutional, and since then North Dakota taxes railroads according to the *ad valorem* system supplemented since 1919 by a 3% income tax.

There remain the Southern states. North Carolina introduced the change in 1889, when a law was enacted providing that in case for any reason the general property tax should not be imposed on a railway, it should be subject to a tax of 1% on its gross earnings. In 1899 this alternative provision seems to have been dropped, but in 1901 a so-called privilege tax on gross earnings, with a graded scale, was introduced which is still in force as a supplement to the general property tax. In Virginia the law of 1842 imposed a tax of 1½% on dividends. In 1855, as amended in 1859, this was changed to a tax of 1 mill per passenger mile plus ½ of 1% on gross earnings from freight. In 1869 the tax was again changed to ½ of 1% on tangible property and on dividends. In 1881 the property tax continued to be levied although now assessed by a state board, but was supplemented by a so-called occupation tax, levied according to net earnings. No machinery, however, was provided to enforce the law which remained a dead letter until 1890 when the requisite machinery was instituted. The net earnings or income tax was at the rate of 1%, and it was provided that income should be ascertained by deducting the costs of operations, repairs and interest on indebtedness from the gross receipts. In 1902, however, the income tax was changed to a tax of 1% on gross receipts, increased in 1915 to 1 1/8%, in 1916 to 1¼% and in 1918 to 1 5/16%, which is still in force and which is levied in

addition to the property tax. In Texas, also, a tax on gross receipts was added to the property tax in 1895, but limited to the receipts from passenger traffic. In 1905, however, it was extended to receipts from all sources, at the rate of 1%. Finally in Mississippi a law of 1880 provided that if a railroad would pay a privilege tax of from \$20 to \$70 per mile it should be exempted from the general property tax for state and county purposes. The law of 1890 increased the rates in this alternative system to \$50–\$150 per mile. In 1892, however, a privilege tax on railroads was imposed, not as an alternative, but as an addition, to the property tax. The law divided railroads into four classes, with a tax of \$2 to \$20 per mile according to the class. This law, with some amendments, is still in force; but the law of 1896 which imposed an additional privilege tax of \$10 per mile on railroads claiming exemption from state supervision under the maximum and minimum provisions in the charter was abolished in 1912.

After this hasty glimpse at some of the typical forms of development, let us now study the existing chaos. Chaos we say, because the remark of the railroad tax committee of 1879 still holds good to-day, that "there is no method of taxation possible to be devised which is not at this time applied to railroad property in some part of this country. A more discouraging example of general confusion could hardly be imagined." [1]

(b) *Actual Conditions*

As stated above [2] nine commonwealths have abandoned property, in the sense of the summation of the actual tangible and intangible assets, as the basis of the tax, and six others have abandoned property as the sole basis. Of these the majority now assess railways on earnings. Five states—California, Connecticut, Maine, Maryland and Minnesota—levy a tax on gross earnings only. In two of these five the tax is graded. In Maine the excise tax is levied at the following rates: on gross receipts less than \$1,500 per mile, ½ of 1%; from \$1,500 to \$1,900 per mile, ¾ of 1%; and for each additional \$400 per mile or part thereof, ¼ of 1% additional until the rate equals 5½%. In the case of railroads operated solely for freight the maximum limit is 3%. In Maryland the so-called franchise tax is imposed at the rate of 1¼% on the first \$1,000 earnings per

[1] *Taxation of Railroads and Railroad Securities*, p. 1.
[2] *Supra*, p. 151.

mile; 2% on earnings from \$1,000 to \$2,000; and 2½% on earnings above \$2,000 per mile. In the three other states—Connecticut, California and Minnesota—the gross earnings taxes are levied at the fixed rate of 3½, 7 and 5 per cent respectively.

Three commonwealths—Massachusetts, New York and Pennsylvania—include railroads in the general corporation tax. New York and Pennsylvania, however, levy an additional tax on intra-state gross earnings (one-half and eight-tenths of one per cent respectively); while Massachusetts also levies an income tax of ¾ of 1 per cent as well as a commission tax on gross earnings in proportion to mileage. In Pennsylvania railroads are therefore now subject to the general corporation tax on capital stock as measured by dividends, to the tax on corporate loans at the rate of four mills, and to the tax on gross receipts at the rate of 8/10 of 1%. They are also subject to the payment of the so-called bonus on charters.[1]

There remains one commonwealth—Delaware—which levies six separate taxes, *viz.*, on capital stock (one per cent), net earnings (ten per cent), locomotives (\$100 each), passenger cars (\$25), freight cars (\$10) and passengers (ten cents each). The companies may, however, pay a gross sum in commutation of the passenger tax.

In addition to the commonwealths which have broken entirely with the attempt to tax railways on tangible and intangible property, six states which retain the property tax as the main feature add other taxes not based on property. Mississippi imposes additional privilege taxes at a fixed sum per mile, according to the reputed wealth or earning capacity of each road. There are five classes: first, second, third, narrow gauge and levee district roads, the tax varying from \$2.50 to \$45 per mile. Ohio levies, in addition to the property tax, four per cent on the gross earnings from intra-state business only. Rhode Island levies, in addition to the tax on tangible property, a tax of one per cent on the proportionate part of the gross earnings within the state, as fixed by relative mileage. Tennessee imposes since 1919 a so-called *inspection and supervision fee* on all public utilities, graded from \$10 to \$500 according to gross receipts in excess of \$5,000 with the maximum fee applicable to gross receipts over \$3,000,000. Texas levies a tax of one per cent on the gross receipts from passenger earn-

[1] *Cf. infra*, p. 215.

ings. Virginia imposes a state franchise tax of 1 5/16 per cent on gross receipts within the state. Virginia also, like Alabama and a number of other states, levies a tax to defray the expenses of the railroad commissioner, apportioned to the railways according to gross receipts. Again, in some of the Southern states we find special licenses levied on railroads, as in Florida where a license tax of $10 per mile is imposed, the proceeds being divided between the state and the counties, with additional local flat licenses of from $10 to $250 according to population; or in South Carolina where a "license fee" of three mills is imposed on the "gross income" of railroads. In Mississippi, Missouri, North Carolina and North Dakota railroads are subject not only to the property tax but also to the recently levied general corporate income tax and in Montana to the 1% income tax on all public utilities, levied under the name of license fee. In Massachusetts, also, railroads have been included from year to year, as an exceptional measure, in the general income tax on corporations.[1] In North Carolina where railroads were formerly subject to an additional graded tax on gross earnings, this was later changed to a mileage tax and again in 1921 to a franchise tax of 1/10 of 1% of the value as ascertained by the State Tax Commission. This is in addition to the corporate income tax. Finally we find in a few commonwealths, like Delaware, Illinois, Maryland, New Jersey, North Carolina and Pennsylvania special taxes levied on special railways.

In considering the newer methods of railway taxation we should in reality add many states which, although included under the head of the *ad valorem* system, yet attempt to assess the value of the franchise. The term *ad valorem* system is in fact deplorably inexact. As commonly understood it means a system of ascertaining the value of the railway as a piece of property, so that it may be put on a par with other property. A valuation reached by adding together the real and the personal property of the railway is without doubt an *ad valorem* method. A valuation reached by taking into account also the value of the stock and bonds would likewise generally be considered an *ad valorem* method. Yet a tax like that until recently in Connecticut where only the value of the stocks and bonds was admitted was called a specific and not an *ad valorem* tax. So again the tax on receipts is termed a specific tax; yet when an attempt is made to ascertain the value of the franchise

[1] *Cf.* for these income taxes, *infra*, p. 211.

and to estimate it on the basis of gross receipts, it is sometimes included in the *ad valorem* system simply because the franchise is treated as property. The whole subject of franchise taxation will be discussed later; but it may be affirmed here that when the value of the franchise is reached by considering only or chiefly the earnings, as is the case in New Jersey, Michigan, Wisconsin and several other states, we are really departing from the *ad valorem* tax considered as a tax on property. For a tax upon property, as based upon or measured by earnings, is really a tax on, or according to, earnings. For instance, in New Jersey the assessors at one time endeavored to estimate the franchise by taking sometimes an arbitrary proportion (sixty per cent) of the surplus of the value of the capital stock and total indebtedness over the value of the tangible property, sometimes a percentage (twenty per cent) of the gross earnings.

In Michigan, as we shall see later, after the tangible property had been assessed, the so-called Cooley-Adams method sought to reach the value of the franchise by a laborious computation designed to ascertain the actual net earnings, which were then capitalized at various rates for the different railways. It is evident that a tax on franchise reached by capitalizing earnings is nothing but a tax on earnings. We are not here discussing which system is preferable. We desire simply to point out that a tax on the property value of the franchise, measured by earnings, is really an indirect tax on earnings; and that a so-called *ad valorem* tax based on earnings is therefore scarcely distinguishable in theory from a specific tax on earnings. This is more or less true of the states which like Michigan, North Dakota, Wisconsin and Vermont have replaced the tax on earnings by an *ad valorem* tax assessed on the property as a unit by a state board.

An important point in the treatment of railroads is the extent to which these new methods of state taxation have superseded local taxation. In no case is the special railroad tax declared to be in lieu of all other taxation, state or local; although it was and is virtually, though not technically, true in Connecticut. For under the former law if the real estate not used for railroad purposes was taxable locally, the valuation on which the state tax was based was reduced by the amount of local taxes; and under the new law of 1915, while the localities have the right to tax the real estate not used exclusively in the business, the local taxes may be deducted from the state tax on gross receipts. In

four cases—Maine, Maryland, Massachusetts and New York—the local bodies may tax railroad property, but with some restrictions. In Maine, only the buildings of the railroad and the lands and fixtures outside the located right of way are taxable locally. Each city or town, however, in which any stock of the railroad is held is entitled to an amount equal to one per cent of the value of such stock as determined by the state board. In Massachusetts, the railroads are taxable locally only on their real estate (except a belt of land adjoining the roadbed with the structures connected with it) and machinery. But as the value of this property is deducted from the total valuation for the commonwealth tax, Massachusetts belongs, strictly speaking, in the preceding category. In Mississippi, only cities and towns have the privilege of taxing railroad property in general, but all local divisions may tax that part which is not used for railroad purposes. In New York, under the general corporation tax law, the real estate of railroads is taxable for state purposes; and both realty and personalty (except intangible personalty) are taxable for local purposes according to the primitive methods of the locally assessed property tax. Railways are also subject to the special franchise tax,[1] which, although assessed by a state board, accrues to the locality. Finally, in California, Minnesota, Pennsylvania and Vermont—the railroads are subject to a local tax only on that part of their property not used for railroad purposes. In California the operative property which is not subject to local taxation is expressly defined in the law of 1910. In Pennsylvania, all property necessary to the successful operation of the railroad including stations, water tanks, *etc.*, but not city offices, has been held to be a part of the franchise, and therefore not locally taxable. But in Pittsburgh all real estate, and in Philadelphia all real estate except the superstructure of the roads and the water stations, is locally taxable. Attention has also been called above to the New Jersey system whereby all operative real estate except the main stem, and all non-operative realty pay the full local rate.

Summing up the American system of railroad taxation we see that there are five principal methods:

1. The primitive system of the general property tax, with local assessment. Although this has well-nigh disappeared for state taxation in general, at least as the exclusive system, it is

[1] *Infra*, p. 225.

still found for purposes of local taxation in many states, including New York.

2. The *ad valorem* system, including at least a valuation of the tangible property, but involving assessment by a state board. This is the system in a majority of the states.

3. The *ad valorem* system, including a valuation of the franchise based in whole or in part on one of the two following methods. This is becoming the rule in a large number of states.

4. The system of specific valuation through the stock-and-bond method or some modification of the same. This is found in only a few states.

5. The taxation of earnings—either gross earnings or net earnings or income. This is found in about a third of the states.

This survey will suffice for a picture of the existing chaos. The theory and criticism must be left to a subsequent section.

4. *Other Public-Service Corporations*

Next in order after the railroads to break away from the general property tax were the corporations which it has become the custom in recent years to call the public utilities or the public-service corporations. Sometimes the term transportation and transmission companies is applied to them. In the broadest sense this term is defensible, as including all corporations engaged in the transportation of passengers and freight and in the transmission of light, heat, power, sound, or intelligence. In some states, however, transportation and transmission companies are considered only a part of the broader category of public-service corporations. For instance in New York the "additional franchise tax" on transportation and transmission companies applies only to "railroad, canal, steamboat, ferry, express, navigation, pipe line, transfer, baggage express, telegraph, telephone, palace car or sleeping car" and "other transportation" companies; while a separate tax is imposed on the other public-service corporations which are specifically designated as "elevated railroads, surface railroads not operated by steam, corporations for supplying water or gas, or for electric or steam heating, lighting or power purposes." The latest definition of public-service corporations is contained in the Rhode Island law of 1912, which taxes "express, steamboat or ferryboat companies; steam and electric railroads; street railways; dining, sleeping, chair or parlor car companies; telegraph, cable and

telephone companies; companies for selling gas, water or electricity for light, heat or power purposes." A slightly different definition is that of the Nebraska law, which includes among the public-utility corporations "street railway corporations, street railways, water works, electric light and gas works, natural gas, mining and all other like corporations." Another definition of public-utility companies, apart from transportation companies is afforded by the Wisconsin law of 1911. They are defined as companies for: (a) generating and furnishing gas for lighting or fuel or both; (b) supplying water for domestic or public use or for power or manufacturing purposes; (c) generating, transforming, transmitting or furnishing electric current for light, heat or power; (d) generating or furnishing steam or supplying hot water for heat, power or manufacturing purposes; (e) improving the navigation of public streams or other public waters; (f) conserving and regulating the height and flow of water in public reservoirs.

South Carolina also has a definition of public-service corporations which includes in addition to some of those mentioned above "navigation companies." In some of the other states, with less inclusive lists, other public-service corporations are occasionally mentioned, like oil pipe lines, bridge companies, toll road companies, messenger companies, press despatch companies, sewer companies, elevator companies, signal companies, dockage or cranage companies, heating and cooling companies, freight line and equipment companies, and terminal companies. All these corporations are deemed to differ from ordinary business corporations in the possession of some special privilege in the use of the land, or in the right of constructing pipes beneath the land or laying wires above the land.

In many of the states these corporations are still taxed according to the ineffective methods of the general property tax with local assessment. In several states they are now taxed according to the *ad valorem* system by a state board and not infrequently according to the so-called unit rule.[1] In not a few states, however, specific taxes are imposed on such companies. In a few states, like Montana, South Carolina, Tennessee and West Virginia, all these public-service corporations are subject to a special tax of the same kind and amount. In other states, like California, the method is the same but the rates differ. In most of the states, however, both rates and methods vary.

[1] *Cf. supra*, p. 150.

On the whole, more progress has been made here than in the case of the railroads which were the first of the public-service corporations to break away from the old system. We shall mention them in the order in which they have begun to assume importance from the fiscal point of view.

The taxation of *telegraph companies* has undergone an evolution similar to that of railroads, but in some respects more complicated. In a large number of commonwealths telegraph property is still included by the local assessors in the general tax list, and pays the regular rate of the property tax. In a smaller number of states, like Indiana, Illinois, Iowa, Kansas, Kentucky, New Hampshire and Tennessee, the *ad valorem* system, administered by a state board, is employed, frequently according to the unit rule. In a few cases again, like Nebraska, where the value of the franchise is separately assessed, the calculation is made on the basis of gross receipts, so that the system ought really to be likened to that now to be mentioned. About one-half of the states, however, have broken away from the *ad valorem* or property system and have substituted one based on gross receipts or on mileage.

The gross receipts system is found in seventeen states, in two of which the tax is graded. The rate of the gross receipts tax is 3 mills in South Carolina, 5 mills in New York, 8 mills in Pennsylvania, one per cent in Delaware and New Mexico, 2 per cent in Ohio and Rhode Island; 2 1/8 per cent in Virginia; 2½ per cent in Maryland; 2¾ per cent in Texas; 3 per cent in Connecticut, Louisiana and Michigan; 4 per cent in Oklahoma; 4¼ per cent in Vermont; 5 per cent in New Jersey and 5½ per cent in California. In Louisiana the tax applies only to foreign companies, domestic companies, if any, being taxable on their property. In Maine the rates are graded from 1¼ to 6 per cent. The Maine tax is in lieu of all taxes on property except the local tax on real estate. Moreover, in Maine it is provided that the state should apportion to the respective localities a sum equivalent to one per cent on the value of the corporate stock held by resident owners. In the above list, six states—Louisiana, Ohio, New Jersey, New York, South Carolina and Virginia—add to the gross receipts tax a tax on property; Maryland adds to the gross receipts tax a tax on shares; and two—New York and Pennsylvania—add the general corporation taxes on capital stock or on stock and bonds. In Vermont the tax on receipts is alternative—at the option of the corporation—

with the tax on mileage, to be mentioned in the next paragraph.

As contrasted with the states that levy a gross receipts tax, nine states impose a tax proportioned to mileage. In five of these the tax is a fixed amount: in Florida 65 cents per mile; in Vermont 65 cents per mile of poles and one line of wire, and 56 cents per mile of each additional wire; in North Carolina $5 per pole mile together with flat local licenses graded from $10 to $50 according to population; in Virginia $2 per mile of poles and conduits and in West Virginia (for foreign companies) $1 per mile. In the other four states the tax is graded: in Alabama the tax is $1 per mile if the line is not over 150 miles, and $500 plus $1 per mile if over 150 miles. In Delaware the tax is 60 cents per mile for the longest wire, 30 cents for the next longest, and 20 cents for any other. In Mississippi the tax is 35 cents per mile together with a property tax. In Tennessee the tax is graded from $20 to $1700 with an additional $10 for each 100 miles over 6,000.

Of these nine states four—Alabama, North Carolina, Tennessee and West Virginia—also levy a tax on property; Delaware, as stated above, also levies a tax on gross receipts; Tennessee levies in addition the inspection and supervision fee applicable to all public utilities; while Virginia imposes all three taxes—a property tax, a gross receipts tax and a mileage tax. Vermont, as stated above, has an alternative system—a tax on gross receipts or on mileage.

In addition to the gross receipts and the mileage systems we find in a few cases other methods. In a few of the Southern states we find a flat license, as in Florida where it is fixed at $500. In Massachusetts telegraph companies are included in the general corporation tax and in Mississippi, Missouri, Montana, North Carolina and North Dakota they are subject to an income tax in addition to the property tax.

In a very few cases only has any state abandoned the gross receipts tax. In Minnesota a mileage tax was first imposed in 1867, but was replaced in 1887 by a gross receipts tax. In 1891, however, the *ad valorem* system was introduced. So Wisconsin replaced the gross receipts tax by the *ad valorem* system in 1905 and Michigan in 1909. In Ohio there was a net receipts tax in 1862, changed to a gross receipts tax in 1865. In 1893 this was abandoned and the *ad valorem* system was introduced; but in 1902 this was supplemented by the excise tax on

gross receipts. In Oregon the gross receipts tax law of 1906 was repealed in 1909. In Georgia there was formerly a gross receipts tax, imposed whenever the property tax did not amount to two and one-half per cent of gross receipts. This method was, however, declared unconstitutional in 1906. On the other hand, Alabama, which formerly imposed a gross receipts tax, substituted, as we know, a mileage tax. The general tendency on the whole, however, has been toward the gross receipts tax.

Telephone companies have naturally been subjected to special taxation only much more recently. With the passage of time the tendency has been for the rate of the tax to increase. For instance, in Wisconsin the gross receipts tax was one per cent in 1883, 1½ per cent in 1885, 2¼ per cent in 1891, 2¼ to 3 per cent in 1897, 2½ to 4 per cent in 1905 and 2½ to 5 per cent in 1911. In Minnesota a 2 per cent gross receipts tax was imposed in 1887; in 1891 this was abandoned for an *ad valorem* tax; but in 1897 the gross receipts tax was restored at a higher rate—3 per cent. In Ohio telephone companies were, like telegraph companies, subjected to a net receipts tax in 1862 which underwent the same changes as those mentioned in the last paragraph, except that the supplemental gross receipts tax which was imposed at the rate of 1% in 1902 was increased to 1.2% in 1910.

At present, the tax on telephone companies is the same as that on telegraph companies in a few states; but in many commonwealths either the rate or the method is different. The gross receipts tax is found in twenty-one states. The rate of the tax is as follows: 3 mills in South Carolina; 5 mills in Louisiana, New York and Oklahoma; 8 mills in Pennsylvania; 1% in Arizona and Delaware; 1.2% in Ohio; 1½% in Texas; 2% in Maryland and Rhode Island; 3% in North Carolina and Vermont; 4% in Connecticut; 5% in Minnesota and New Jersey; and 5½% in California. In three states the tax is graded: in Maine the grades and rates are the same as in the case of telegraph companies, explained above. In Virginia the rate is 1 1/10% when (a) gross receipts do not exceed $50,000 a year, and (b) when the pole-mileage is not above 600; otherwise (c) the rate is 1 1/16% on gross receipts to $50,000 and 2 1/16% on receipts in excess of that sum. In Wisconsin the so-called license fee is 2½% if gross earnings are under $100,000, 3% between $100,000 and $300,000, 4% between $300,000 and $500,000 and 5% if over that sum; and it is provided that

15% of the revenue should accrue to the localities. In North Carolina the rate of tax is reduced if a certain proportion of the assets of the corporation is invested in state or local bonds of North Carolina: if the proportion is one-quarter, the rate is reduced to 1½%; if one-half, the rate is 1%; and if three-quarters of the total assets are so invested, the rate is only ½ of 1%. Tennessee includes telephone companies in the inspection and supervision fee, levied according to gross receipts, on all public utilities. On the other hand, Michigan and Oregon abandoned the gross receipts tax in 1909 and replaced it with the *ad valorem* system.

Of the above states, four—New Jersey, Ohio, South Carolina and Tennessee—add to the receipts tax a tax on property; and Virginia adds a tax on property and a tax on mileage. Two states—New York and Pennsylvania—add the general corporation taxes on capital stock or on stock and bonds; while Vermont permits as an alternative the tax on mileage.

As contrasted with these twenty-one states, six commonwealths impose a tax on mileage, several of them combining with the mileage tax other taxes. Alabama levies a privilege tax of 25 cents a mile if the length of the wires is less than 50 miles; but otherwise imposes a tax of $1,000 plus $2 a mile and in each case also levies the property tax and local licenses from $5–25. Delaware levies a tax of 60 cents per mile of wire, for the longest wire, 30 cents per mile for that next in length, and 20 cents per mile for all others; together with a tax of 25 cents per transmitter. Mississippi levies a flat tax of from $2.50 to $250 on each telephone exchange, graded according to the number of subscribers and to the number of miles of poles. Virginia imposes a tax of $2 per mile, in addition to the property tax and to the receipts tax. Vermont levies a mileage tax like that on telegraph companies, and permits in lieu of this the gross receipts tax mentioned above. West Virginia levies a tax of $1 per mile in addition to the property tax.

In a few states we find taxes apportioned to the instruments used. Thus Montana imposes a tax of 75 cents per transmitter, while Florida and Tennessee grade the tax. In Florida the tax is 10 cents per transmitter up to 1,000 transmitters, 8 cents up to 2,000, 6 cents up to 3,000. In Tennessee the tax is from 20 to 50 cents per transmitter, graded according to the population, in addition to the property tax. Moreover, as intimated above, Delaware also employs this method in part. Finally,

telephone companies are subject in Mississippi, Missouri, Montana, North Carolina and North Dakota to an income tax.

In the case of *express companies* the states have as a rule departed from the property tax system to an even greater extent than in the preceding cases. Only a few states have reverted to the *ad valorem* system, and there frequently because of a constitutional defect in the particular method employed. For instance, Iowa started in 1868 with a tax on the personal property of express companies which was declared to be equal to 40% of their gross receipts. In 1870 Iowa reverted to the general property tax, but in 1896 again imposed a gross receipts tax at the rate of 1%, which was increased in 1898 to 2%. In 1900, however, this tax was overturned by the Supreme Court, and Iowa now adopted the *ad valorem* system with the unit rule. In Georgia also the alternative gross receipts tax, first levied in 1901, was abandoned in 1908 owing to a court decision. In Michigan the gross receipts tax was replaced by the *ad valorem* system in 1901 and in Wisconsin this occurred in 1899. Ohio levied a net receipts tax in 1862, and changed in 1865 to a gross receipts tax. But in 1893 the *ad valorem* system was established, coupled, however, with a gross receipts tax at 2%, changed in 1902 to 1%, and again raised to 2% in 1910.

Many more states, however, have on the contrary during recent years abandoned the older methods for the gross receipts tax. No less than thirty states now tax express companies according to gross receipts. The rate is as follows: 3 mills in South Carolina; 5 mills in New York; 1 to 5% in Pennsylvania; 1% in California and Louisiana; 1¼% in Missouri; 1½% in Virginia and West Virginia; 2% in Connecticut, Florida, Nebraska, New Jersey and Ohio; 2½% in Maryland, Missouri, Montana, New Jersey and Texas; 3% in Idaho, Oregon and Rhode Island; 4% in Kansas, Maine and Oklahoma; 5% in New Mexico, Washington and Wyoming; 6% in Arizona and Delaware; and 8% in Minnesota. Where the high rates are levied, the gross receipts tax is sometimes in lieu of all taxes on property, as in Connecticut and Minnesota. In Kansas, Rhode Island and Washington, however, the corporations are taxable also on their tangible property. In California they are taxable only on their local real estate. In most of the other states they are subject also to the property tax, either for local purposes, or for both local and state purposes, as in Missouri, Ohio,

South Carolina and West Virginia; or on the property excluding the franchise, the franchise being deemed to be taxed through the receipts tax. In New York and Pennsylvania express companies are also subject to the general corporation taxes. In Wyoming the tax is divided in equal proportions between the state and the several counties in which the company operates. In Louisiana the tax seems to apply only to domestic companies.[1]

As compared with the states employing the gross receipts tax only six states utilize the mileage tax for express companies. Alabama levies a tax of $1 per mile where the express lines do not exceed 500 miles, but thereupon imposes a flat tax arranged in classes, the maximum tax of $5,000 being paid when the mileage is over 4,000 miles. Mississippi levies a tax of $500 plus $6 a mile in the case of first class railroad track, or $3 a mile in the case of second or third class railroad track [2] over which the business is operated. North Carolina imposes a license tax ranging from $5 to $7 a mile according as the net earnings are less than 6% or more than 8%. Towns may impose a further flat license tax graded from $5 to $75 according to population. Tennessee imposes a tax of $1,000 on all companies with lines less than 100 miles long, but $2,500 where the length is over 100 miles. In Tennessee they are also liable to the inspection and supervision fee on gross receipts. West Virginia imposes a tax of $1.50 per mile in addition to the property tax. Vermont, which from 1880 to 1904 imposed a gross earnings tax, levied in that year a tax at the flat rate of $8 per mile, in lieu of all taxes on property. This arbitrary tax was due to the refusal of the companies to furnish adequate details of their business. In 1912 the rate was increased to $20 per mile and in 1915 reduced to $16 per mile, at which it now stands.

In addition to these receipts and mileage taxes we find sporadic instances of other methods. Thus Florida levies a flat tax of $7,500 per annum in lieu of all state and county licenses, but permits in addition city or town licenses, with rates from $6 to $200. In Massachusetts express companies are subject to an excise tax, like the general corporation tax on corporate excess, except that the tax instead of being computed on the basis of capital stock alone, is computed on the basis of

[1] See State *vs*. Pacific Express Co., 121 La. 151. But see State *vs*. Hammond Packing Co., 110 La. 180.

[2] For an explanation of these terms *cf. supra*, p. 178.

the shares, bonds, and unfunded debt, and with the further exception that only so much of that valuation is taken as the gross receipts within the state bear to the total gross receipts. In Delaware express companies pay an annual license fee of $250 in addition to the gross receipts tax. Finally in Mississippi, Missouri, Montana, North Carolina and North Dakota express companies are subject to the public utilities or general corporate income tax.

In some states, as in Maryland and West Virginia, the gross receipts tax applies only to foreign companies, the domestic companies being subject to the general property tax. As a matter of fact, however, the express companies are foreign companies in most of the states.

From the fact that the large express companies are generally unincorporated, the question has recently arisen whether they are liable to the corporation tax. In Vermont and Pennsylvania joint-stock companies are expressly included. In New Jersey the tax law applies only to corporations. In New York express companies have been declared liable to the state corporation tax because the statute expressly applies to joint-stock companies; [1] but under the provisions of the revised statutes imposing a tax on "all monied or stock corporations," which still governs local taxation in New York, it has been held that the unincorporated joint-stock express companies are not liable to local taxation.[2]

Parlor and sleeping car companies have been separately taxed in a smaller number of states. In some states like Georgia the *ad valorem* unit rule system is employed, whereby the ordinary rate of the property tax is levied on that proportion of the entire value of all the cars of the company which the state mileage over which the cars are run bears to the entire mileage. In fifteen commonwealths we find the gross receipts tax, in many of them drawing room, dining, chair and buffet cars being expressly designated as included in the general category. The rates are as follows: 3 mills in South Carolina; 5 mills in New York; 8 mills in Pennsylvania; 1% in Rhode Island; 1½% in Delaware and Florida; 2% in New Jersey; 2½% in Maryland; 3% in North Carolina, Oklahoma and Oregon; 5% in Minnesota and Texas; 5¼% in California; 7% in Washington and 9% in Maine. In several of these states an additional tax on property is levied, as in Rhode Island and South Carolina. In Minnesota

[1] 117 N. Y. 136. [2] 133 N. Y. 279.

the tax is alternative with a property tax. In Maryland an additional tax is levied on the capital stock of domestic companies only. In Texas an additional tax of ¼ of 1% on capital stock is levied on all such companies, but they are then exempt from all other taxes.

As contrasted with these taxes on receipts, several states, principally in the South, impose so-called license fees or privilege taxes in addition to the property tax. In Alabama the tax is $8,000; in Florida it is $5,500 together with a tax of $10 per mile, both of which are paid in addition to the gross receipts tax; in North Dakota the tax is at the flat rate of $100; in Tennessee the tax is $3,000 in lieu of all other taxes except on property.

The mileage tax is found in Mississippi, which levies a tax of from $2.50 to $3.50; in Virginia, which levies a tax of $3.15 per mile together with an annual registration fee; and, as stated above, in Florida. Finally there may be mentioned Ohio which imposes a tax of 1.2% on the excess of the value of the capital stock, as proportioned to Ohio, above the value of the real estate; and Vermont which imposes a tax of 1¼% on the proportion of the capital stock invested or used in the state. In Montana, Missouri and North Dakota they are also liable to the corporate income tax; and in Tennessee to the inspection and supervision fee on gross receipts.

In addition to the palace and sleeping car companies tax we find separate mention made of other *car companies* in seventeen states which impose a special tax. Alabama taxes freight or equipment companies 3% on gross income; Arkansas imposes an excise or privilege tax of 5% on the gross receipts of all private car companies; California taxes refrigerator, oil, stock, fruit and other car-loaning companies at the rate of 5¼% on their gross receipts; Connecticut taxes car companies 3% on gross receipts; Maryland taxes freight lines 2% on gross receipts; Minnesota imposes a tax of 6% on the gross receipts of freight line companies, which are defined as companies engaged in operating box, flat, coal, ore, bank, stock, gondola. furniture, refrigerator or other cars over any railroad line; Mississippi taxes car equipment companies 3% on gross receipts in lieu of the property tax; Montana taxes private car companies 5% and North Carolina 3% on gross receipts; North Dakota taxes freight lines and car equipment companies 6% on their gross receipts; Oklahoma taxes stock car, refrigerator car, and other private car companies, car trusts and car associations

at the rate of 4% on gross receipts; Oregon taxes refrigerator cars 3%; Rhode Island taxes car companies 1%; Texas taxes stock, refrigerator, fruit and other car companies 3%; Vermont imposes a tax of 2½% on the gross earnings of car, steamboat and transportation companies as an alternative to the tax of 1¼% on appraisal; Virginia taxes car companies 4¼%; and Washington levies a tax of 7% on the gross receipts of car companies in addition to a tax on their tangible property.

The next class of public-service corporations which are sometimes taxed in a special way, is composed of *street railways*. These are specifically mentioned in thirteen states. In Tennessee they are taxed on mileage, the privilege tax being graded from $3 to $10 per mile of track according to the population. In the other states the tax is levied on gross receipts. The rates are as follows: 2 mills together with local licenses not exceeding 2% in Alabama; 3 mills in South Carolina; 1% in New York and Rhode Island; 1.2% in Ohio; 4½% (after 1921, 3%) in Connecticut and 5¼% in California. In New York, however, they pay in addition 3% upon the dividends in excess of 4%; but where the property of such a corporation is leased to another, the gross receipts tax is omitted. In Rhode Island street railways pay in addition to the 1% tax imposed in 1912, which is deemed to be in lieu of all taxes on the security holders, a so-called franchise tax imposed in 1909, which consists of a second tax of 1% on gross receipts, as well as on net earnings over 8%. Moreover, street railways in Rhode Island are also liable to the general property tax, and to any other taxes that are or may be imposed on all persons or corporations. At present this means an additional tax on tangible property. In three states the gross receipts tax is graded. In Maine the rate is graded from 1 to 4%. In Massachusetts the rate of the so-called commutation tax on street and electric railroads varies from 1 to 3%. This tax is supplemental to the general corporation tax and also to the so-called additional corporate franchise tax which takes for the state any excess of dividends over 8% on the capital stock in the case of corporations that have paid an average dividend of 6% since their formation. In Texas interurban roads connecting cities of 10,000 inhabitants or over pay from ½ to ¾ of 1% of gross receipts, according as the population is under or over 20,000. In New Jersey the rate is 2% on receipts up to $50,000, and 5% on the excess. They are also subject to a

tax at the "average rate of taxation" of the state, upon their entire gross receipts, in lieu of the tax formerly levied on their personal property. In almost all the above cases the tax applies to interurban as well as city or town street railways. The street railway tax is generally reserved for state purposes, but in some cases it is handed over in part or whole to the localities. In New York, *e. g.*, the tax is imposed on such proportion of gross receipts as the mileage on the highways bears to the total mileage, and is distributed in the local districts in proportion to the value of taxable property of the street railways therein. In Wisconsin the gross receipts tax on street railways was replaced by the *ad valorem* system in 1905.

Another class of public-service corporations is composed of *gas or electric light, heat or power companies*. We find them specifically mentioned in fourteen states. The usual tax again is on gross receipts. The rates are as follows: 2 mills, together with local licenses, in Alabama; 3 mills in South Carolina (light and power companies); ¼ to ½ of 1% in Texas (gas, electric light, power and water companies); ½ of 1% in Maryland, New Jersey and Oklahoma; 25/32 of 1%, together with the property tax, in Virginia; 1% in North Dakota, Rhode Island (gas, electric and power companies) and West Virginia; 1.2% in Ohio (gas, electric and natural gas companies); 1½% in Connecticut; 2½% in Georgia; and 7¼% in California (transmission or sale of gas or electricity). In Delaware the tax is 2.5 of 1% of gross earnings plus 4% on dividends over 4%. In New Jersey they are subject to the same additional tax on gross receipts as that mentioned in the preceding paragraph as applicable to street railway companies. In New York the tax, which applies to gas, electric or steam heating, lighting and power companies and water works companies, amounts to ½ of 1% on gross earnings together with a tax of 3% on dividends in excess of 4%. Such companies are then exempt from the general corporation tax. In Pennsylvania, on the other hand, similar companies are subject to the general corporation tax. Finally in some of the Southern states gas and electric companies are subject to privilege or license taxes. In Florida this is graded from $10 to $250, with 50% additional for the use of meters. In Mississippi it is graded from $50 to $500, and in Tennessee from $50 to $700 according to population. In Alabama gas and electric light and power and water works companies are subject to local licenses of from $5 to $100 per city or town according to population.

There still remain a few classes of public-service corporations in which we find an occasional example of specific taxation. Among them may be mentioned the following:

Water companies are taxed separately in Connecticut (1½% on gross receipts); California (1 2/10% on the franchise valuation); Florida (state licenses of from $50 to $150 and local licenses of from $25 to $50 according to population); Ohio (1.2% on gross receipts); Oklahoma (¼ of 1% on gross receipts); North Dakota (3% on net income); New York (½ of 1% on gross receipts together with 3% on dividends over 4%); Rhode Island (1% on gross receipts in addition to the property tax); South Carolina (3 mills on gross income in addition to the property tax); Tennessee (license tax) and Virginia (2 5/32 of 1% on gross receipts in addition to other taxes).

Oil pipe lines, or as they are sometimes called simply pipe lines, are taxed separately in California (1.2% on franchise valuation); Delaware (3/5 of 1% on gross earnings); Kentucky (1% on the value of the oil); Maryland (2% on gross receipts); New Jersey (2 to 5% on gross receipts); New York (½ of 1% on gross receipts together with 3% on dividends over 4%); North Dakota (3% on net income); Oklahoma (2% on gross receipts); Ohio (4% on gross receipts); and Texas (2% on gross receipts).

Navigation companies are taxed in Florida (3 cents per net ton of registered tonnage); Indiana (3 cents per ton); Michigan (river improvement companies, 1% on paid up capital); Minnesota (3 cents per ton); New York (½ of 1% on gross receipts and 3% on dividends over 4%); South Carolina (3 mills on gross income).

Steamboat companies are occasionally taxed separately, as in New York (½ of 1% on gross receipts in addition to the general corporation tax); Rhode Island (1% on gross receipts in addition to the property tax); and Virginia (1 3/16% on gross receipts in addition to the property tax.

Terminal companies or union depot companies are taxed separately in Ohio (1.2% of gross receipts); Tennessee (license tax) and Texas (1% of gross receipts).

Heating and cooling companies are taxed in New York (½ of 1% of gross earnings); and Ohio (1.2% of gross earnings).

Messenger or *messenger and signal companies* are taxed separately in New Jersey (2% of gross receipts); and Ohio (1.2% of gross receipts).

Road companies are specifically mentioned in Michigan and taxed 2½% on gross earnings.

Foreign *bridge companies* are taxed in Indiana on earnings, but the earnings are treated as personal property and put into the regular tax list.

Toll bridges and ferries are taxed in California 1.2% on their franchise valuation, and together with canal ditches, tramroads and poleroads used for transporting timber or other valuable articles of commerce are taxed in Alabama on their gross receipts at the general property tax rate.

Cable companies are taxed in Delaware 1% on their gross receipts.

Finally all *public utilities* are taxed 1% on their net income in Montana, and pay a license tax on their capital stock in West Virginia; while in New Jersey all corporations using or occupying the public streets or highways are subject to the tax on gross receipts which is at the rate of 2% on receipts of $50,000 or less and 5% on all amounts in excess of $50,000; and in Tennessee all public utilities are subject to the inspection and supervision fee ranging from $50 to $5,000 according to gross receipts.

Outside of the public-service corporations mentioned above we also find a special tax on *building and loan associations* in Alabama (1 per mill on the capital stock up to $100,000 and ½ of 1 per mill on sums above that figure); Kentucky (2% on gross receipts of foreign companies); Maine "capital dues" of ¼ of 1%); and Vermont (building investment companies, 1% on sums loaned).

This completes the list of the special taxes levied on particular classes of corporations. We thus come to the third movement, away from the property tax which, as noted above, has been the introduction of a tax applicable to all corporations in general. In other words, we have now to deal with

5. *The General Corporation Tax*

Here again Pennsylvania took the lead, for in that state the tax is far older than might be imagined from its recent introduction into other commonwealths. We have already seen that in 1824 Pennsylvania imposed a tax on the net dividends of banks. In 1836 the tax was extended to iron companies, at the rate of eight per cent on all dividends exceeding six per cent. In this provision can be found the germ of the later laws. The first general corporation tax, imposed in 1840, provided

that "banks and all corporations whatever" which declared a dividend of one per cent should pay "in addition to all present taxes" one-half mill for each dollar of the dividend or profit, and an additional one-half mill for every additional one per cent of dividend. In 1844, however, an act was passed which sketched in broad outline the path of future development. According to this law all domestic corporations which made or declared a dividend or profit of at least six per cent paid a tax on capital stock of one-half mill for each one per cent of dividend; but if the dividend was less than six per cent, the tax was three mills on the dollar. This law continued until the act of 1859 provided that the three mills tax should be paid only if no dividend was declared; but that in case of any dividend (not, as before, a six per cent dividend) the tax should be one-half mill on the capital stock for each one per cent of dividend. In 1864 it was provided that corporations not paying to the state a tax upon dividends should pay three per cent on net earnings. The consolidated act of 1868 excepted from the general corporation tax only banks, savings institutions and foreign insurance companies (all of which were separately taxed), but imposed a tax of three per cent on the net earnings or income of all corporations, except those liable to the tonnage tax, *i.e.* the transportation companies.

The important feature of this law, however, was that the capital stock tax was now made applicable to all companies incorporated or doing business in the state, *i.e.* to foreign as well as to domestic corporations. Only from 1868, therefore, was the Pennsylvania tax a general corporation tax. The general law of 1874 made no change except in respect to transportation companies as mentioned above, and with the further exception that coal companies were to pay a franchise tax of three cents per ton transported. In 1879 the line of division in the tax was again drawn at dividends of six per cent—that is, the principle of the law of 1859 was abandoned and that of 1844 reinstated. Limited partnerships, except those organized for manufacturing or mercantile purposes, were put on the same footing as corporations; and the tonnage tax on coal companies was limited to 1881, after which it was to cease. Manufacturing corporations with certain exceptions were exempted from taxation for state purposes, and a loan tax of four per cent was imposed, applicable also to the bonds of corporations. In 1885 the latter was reduced to three per

cent. In 1889 the rate of the capital stock tax was fixed at one-half mill for each one per cent of dividend, if dividends amounted to six per cent, and at three mills when dividends were less than six per cent. Finally, in 1891 this plan was abandoned and the amendments adopted which, as still further altered in 1893, are now in force.

Under the law as it now stands in Pennsylvania, the "tax on corporation stock" applies to all corporations, joint-stock associations and limited partnerships doing business in the state or having any portion of their capital invested therein, except banks and savings institutions, foreign insurance companies, building and loan associations and manufacturing companies to the extent of the capital stock invested in, and actually and exclusively employed in carrying on manufacturing within, the state. Corporations engaged in the brewing or distilling of malt or spirituous liquors, and such as enjoy and exercise the right of eminent domain, are not included in this exception. Bourse companies are exempt as to a certain proportion of their capital stock. Banks and insurance companies, however, are, as we know, taxed separately, while building and loan associations pay on their matured stock a tax equal to the state tax on moneys at interest, and distilling companies pay a separate tax on capital stock at the rate of one per cent. The rate of the general capital stock tax is now uniform—namely, five mills on each dollar of the actual value of the whole capital stock of all kinds. This value, ascertained by appraisement, must not be less than the average price for which the stock has been sold during the year, nor less than the value indicated by the net earnings or by the profit in dividends or by what has been carried to the surplus or sinking fund. If any profit has been added to the sinking fund, it is treated as if it had been devoted to dividends, unless it is set apart expressly for the payment of debts. In the case of fire and marine insurance companies the rate is three mills on each dollar of capital stock.

In addition to this tax on corporation stock, there is a tax of three per cent on the net earnings of unincorporated banks and all corporations except those liable to the previous tax or to the tax on gross receipts. The only corporations which would be liable under this provision are banks and manufacturing corporations; but the latter, with the exceptions just noted as liable to the tax on corporation stock, are now ex-

pressly exempt from all taxation; and the former, by electing to pay ten mills on the par value of their capital stock, secure exemption from all other taxation except on their real estate. Thus the net earnings tax does not apply to corporations at all. It is levied chiefly on unincorporated savings banks and on trust companies without capital stock. If the banks do not elect this ten mills tax, the market value of the stock is assessed to the stockholders and taxed four mills, and the banks are further subject to local taxation. It has already been noted above in the proper connection that transportation, transmission, electric light and insurance companies pay a tax on gross receipts or premiums in addition to the general corporation tax.

In addition to the tax on capital stock, Pennsylvania imposes a "tax on loans," which exacts four mills on the dollar of all interest paid on any scrip, bond or certificate of indebtedness issued by any private corporation, and on all public loans (except those of Pennsylvania and of the United States). The tax was first imposed in 1864 in the shape of a tax on the loans themselves. In 1868 this was altered, so far as corporate loans are concerned, to a tax of 5% on the interest paid. In 1873 the law was modified and in 1874 the tax was abolished. In 1879, however, it was restored in the shape of a tax on the corporation. But this law, like its successor of 1881, was declared unconstitutional; and it was not until 1885 that the tax was re-established at the rate of three mills on the dollar, changed in 1891 to four mills, at which it now stands. This tax must not be confused with the tax on loans or mortgages in the hands of corporations, which is a part of the general state tax on personal property. For it has been held that corporations and associations liable to the capital stock tax shall not be required to pay any further tax on mortgages, bonds or other securities belonging to them, and which constitute any part of their assets included within the appraised value of their capital stock. But if they hold these bonds in a fiduciary capacity, they are liable. On the other hand, the tax on the loans made by corporations, *i.e.* on corporate obligations, has been upheld as a proper exercise of the legislative authority and as not in conflict with any provision of the federal constitution. It is deemed to be in effect a tax on the bondholder, not on the corporation, although the corporation is required to advance the tax and to deduct it from the interest.

The treasurers of corporations, therefore, pay the tax on all their bonds or obligations unless affirmative proof is offered that the owners reside out of the state, and then deduct the tax from the interest due. The tax is, however, not payable on bonds owned by non-residents. If the bonds are sold "free of tax," that is, without recourse to the bondholder, the right of the state to collect from the corporation is no wise affected.

Certain classes of loans have been declared non-taxable, either by special enactment or by judicial construction. These are as follows:

(1) Obligations held in their own right by corporations paying the capital stock tax; for such obligations enter into the value of the capital stock which is taxed; (2) obligations held, or notes discounted or negotiated, by trust companies, national, state and savings banks; (3) obligations held by non-residents in their own right, and by persons whose residence is unknown; (4) obligations held by institutions organized for purely charitable or religious purposes; (5) obligations of their members held and owned by building and loan associations; (6) obligations on which no interest has been paid or earned during the tax year, from which the tax could have been deducted.

This general corporation tax, it is important to note, is in lieu of all local taxation on personalty. In Pennsylvania, therefore, corporations subject to the capital stock tax are, with some exceptions noted below, locally taxable only on real estate; while public-service corporations, which are subject to the gross earnings tax, are not taxable locally even on their real estate.

The law of 1885 exempted manufacturing corporations (with certain exceptions) from all taxation for state purposes; but it was held that only that part of the capital of a manufacturing company which was invested in the plant actually necessary for the manufacture of its products could be exempted, and that the capital of such companies invested in mines for the production of coal to be used in the process of manufacturing, or any other capital similarly invested, was taxable. The laws of 1889 and 1891, however, provide for the exemption of those companies only which are organized exclusively for manufacturing purposes, and the law of 1893 specifically limits the exemption to that part of the stock which is exclusively employed in carrying on manufacturing within the state. If the capital is invested in property which it is merely con-

venient to use in connection with manufacturing operations, it is not exempt.[1] Manufacturing companies are held to be limited to those that produce material substances. Laundry companies and steam heat companies, *e.g.* are not considered manufacturing companies. In the case, however, of the tax on loans, since, as we have just seen, it is held to be not upon the corporation but upon the moneys of the bondholder, manufacturing corporations are liable equally with others.

In New York the general corporation tax came later; for not until 1880 was a law passed which was based on the Pennsylvania act. This act levied a tax on the par value of the capital stock as fixed by the state board, making the rate 1½ mills on the dollar if the dividends were less than six per cent or if there were no dividends at all, and ¼ mill for each 1% of dividends if the dividends were 6% or more. The law has been repeatedly amended in important details, especially by the laws of 1885, 1889, 1890, 1896, 1901, 1906 and 1910; but the main outlines remained unaltered. Among the more important recent changes are the following: In 1896 only that part of the capital employed within the state was declared taxable, although the practice had been to that effect for some time. In 1901 manufacturing companies, which had hitherto been exempt only when their capital had been exclusively and wholly engaged in manufacturing within the state were declared exempt if 40% of their capital was so invested. In 1906 several alterations were made. The rates were now further differentiated according to the amount of business and the character of the enterprise, so that they were fixed at ¼, ¾ or 1½ per mill, respectively, as will be explained below. The other important change affected foreign corporations which invest their capital in the stock of another corporation doing business in the state. These foreign companies had not been considered engaged in business in the state. In 1906 they were made taxable by the provision that the capital of a corporation invested in the stock of another corporation should be deemed to be assets located where the property represented by the stock is located. This of course also changed the reverse rule according to which a domestic corporation whose capital was invested in the stock of a foreign corporation had been taxable, but was now exempt.

The tax, known as the corporation or franchise tax or the

[1] For a discussion of these points see Eastman, *The Law of Taxation in Pennsylvania*, 1909, p. 671 *et seq.*

capital stock tax, applied to all corporations except the following: banks, trust companies and savings institutions; insurance, title guaranty and surety companies; elevated railroads and surface railroads not operated by steam; water, light, heat and power companies; agricultural and horticultural associations; and manufacturing, mining and laundering companies, to the extent only of the capital actually employed in manufacturing, mining or laundering, provided that at least 40% of the capital was invested in the state and used by them in manufacturing, mining or laundering. All of these exempt corporations, however, except the two last categories (agricultural and manufacturing) were reached by separate specific taxes, as we have learned above.

The tax is assessed according to the capital stock. Originally the rate was just one-half of that of the original Pennsylvania prototype. At present, however, the rate of tax is determined according to very complicated rules. In reality there are in New York no less than six different classes, although the rather confused law does not clearly differentiate them. They are as follows:

1. Corporations paying dividends of six per cent or more are subject to a tax of ¼ of a mill for each 1% of dividends, the tax to be computed on the par value of the capital stock. This it will be observed is equivalent to an income tax of 2½%.

2. If the corporation pays no dividends, the rate is ¾ of a mill, the tax being computed on the appraised value of the issued capital stock employed within the state.[1] The measure of the amount of capital stock employed within the state is declared to be such a portion of the issued capital stock as the gross assets employed in any business within the state bear to the gross assets wherever employed in business. For purposes of taxation the capital of a corporation invested in the stock of another corporation is deemed to be assets located where the physical property represented by such stock is located.

3. Corporations paying less than 6% dividends, whose liabilities equal or exceed their assets (*i.e.* which are insolvent), or the average selling price of whose stock has been below par during the year, are subject to a tax of ¾ of a mill, computed on the appraised value of the stock employed within the state.

4. Corporations paying less than 6% dividends whose assets exceed their liabilities by an amount equal to, or greater than,

[1] See 198 N. Y., 246.

their capital stock, or the market price of whose stock equals or exceeds par, pay 1½ mills on the capital stock employed within the state; and it is further provided that in this case the value of the capital stock shall not be less than par, or less than the difference between the assets and the liabilities, or (if the stock was sold) not less than the average market price at which the stock was sold. Whichever of such valuations is the highest is to be taken as the value of the stock, on which the tax is computed.

5. All other corporations, that is, corporations paying dividends of less than 6% and whose assets exceed their liabilities, but not by an amount equal to, or greater than, the capital stock, and whose stock has no market price, pay a tax of not less than 1½ mills on the value of the capital employed within the state, or 1½ mills on the average market price of the stock.

6. Corporations having two or more kinds of capital stock upon which the rates of dividends vary pay a tax on each kind of stock according to the respective class in which they fall, as explained in the preceding five categories.

Corporations subject to the capital stock tax are exempted from all state taxation on their personal property; but they are liable to local taxation on their whole property, both real and personal, according to the primitive methods.

In 1917 the entire system of franchise taxes was changed by making business corporations subject to a tax of 3% (increased in 1919 to 4½%) on their income. The only exceptions were holding and real estate corporations as well as the public utilities and the financial companies subject to special taxes. In compensation for the income tax business corporations were freed from the local tax on personal property or on capital stock. The result of this new law is that the old corporate franchise tax is now applicable only to public utilities.

In Massachusetts, the general corporation tax dates from 1864. In 1863 indeed, a law was enacted which taxed dividends paid by corporations to non-resident stockholders; but this was pronounced unconstitutional, and was replaced by the law of the following year. This was an extension to corporations in general of the law of 1832, which as we remember [1] was applied to manufacturing corporations only. The tax was levied on all corporations except banks and mining com-

[1] *Supra*, p. 147.

panies. Banks were separately taxed as has been explained above. Domestic mining companies were also separately taxed by a law of 1864 at 7-12 of 1% on the value of the capital stock; and in the following year foreign companies were taxed at the rate of 1-20 of 1% (reduced in 1883 to 1-40 of 1%). In 1879 corporations engaged in building railroads and telegraphs in foreign countries were also excepted, but were then taxed by a special law at the rate of 1-20 of 1% on the par value of the capital stock, together with 4% on dividends. The general law applied only to domestic companies, and this has continued to be the case with a few exceptions. In 1865 foreign telegraph companies were included; in 1885, foreign telephone companies; in 1898 foreign street railways; and in 1906 foreign railroads.

The act of 1864 laid down the general principle which is still followed to-day. The basis of the tax was the market value of the capital stock after deducting the value of the real estate and machinery, if any, which were locally taxable. The tax commissioner, on the basis of returns made by the corporations, was to estimate the fair cash value of the shares constituting the capital stock. This was to be regarded as the true value of the corporate franchise. The excess of this value over that of the corporate property locally taxed was termed the corporate excess, and on this excess the tax was assessed. In 1864 the rate was 1.6%—the average rate of the general property tax at that time. In 1865 the rate was made to fluctuate with the average rate on property in general from year to year. The tax was paid to the state treasurer, and was by him distributed to the localities in accordance with the residence of the shareholders, to be offset against the sums due to the state from the localities for the property tax and the bank tax. The state, however, retained the amount of the tax corresponding to the value of the shares held by non-residents.

Thus remained the system without any changes of importance for over three decades, with two exceptions. In 1865 a law was passed providing that in the case of railroads and telegraph companies only that proportion of the capital stock should be taken that corresponded to the Massachusetts proportion of the total mileage. In 1885 the law was extended to foreign telephone companies, but with the criterion of the number of instruments used. Toward the end of the century, however,

the growing importance of the street and electric railways brought about a demand for a heavier tax, and for an increased revenue to the localities. Both of these objects were accomplished in 1898. The distribution of the corporate excess to the localities was changed from the basis of the residence of the stockholder to that of the location of the line. Furthermore an additional franchise tax was imposed on street railways, amounting to the entire excess of dividends over 8%, provided the corporation had paid an average dividend of 6% since its formation. In 1906 electric roads, constructed partly on private property, partly on public highways, were made taxable like street railways, with the exception that only so much of the proceeds as corresponded to the length of track on public highways was to be distributed to the localities, the remainder being distributed like the ordinary tax on corporate excess.

A few years later there developed considerable dissatisfaction with the taxation of domestic business corporations, as distinguished from the public-service and the financial corporations. Domestic business corporations were taxed more severely than their foreign competitors, that is, foreign corporations doing business in the state, as well as similar corporations in the neighboring states. As to the latter we have learned that in New York and Pennsylvania manufacturing corporations were in large measure exempt; and in the other New England states there was no effective tax at all on such corporations. As to foreign corporations doing business in Massachusetts, these were liable only for their tangible property, taxed locally. The shares were indeed taxable to the shareholder if discovered; but this was an eventuality that almost never happened. This discrimination against domestic companies was removed by the law of 1903. Henceforth there were to be deducted from the value of the stock of ordinary business corporations: (1) the value of the real estate and machinery, whether located in or out of the state; (2) all other tangible property located out of the state and liable to taxation, whether taxed or not; and (3) securities which were exempt in the hands of a citizen of Massachusetts (*i. e.*, stocks of state corporations and of other corporations taxed in the state on their franchises, mortgages or bonds exempt from taxation). The minimum tax was one corresponding to one-tenth of one per cent of the market value of the stock. The maximum limit was reached by taking one hundred and twenty per cent of the valuation of the real

estate, machinery, tangible property and securities taxable to residents of Massachusetts and deducting the value of all property liable to taxation.

A second change made by another law of the same year was the imposition on foreign corporations of a slight excise tax, at the rate of 1–100 of 1% of the par value of the capital stock, with a deduction for taxes locally paid, and with a maximum limit of $2,000.

During all these years the rate of the corporate-excess tax had been reached by dividing the taxes on property, exclusive of polls levied in that year, into the total valuation of property in the state for the preceding year. In 1906 the rule was changed for all corporations except street and electric railways, so that in future the rate was made the average for three years. In 1909 this new rule was made uniform on all corporations, without exception.

During the first decade of the new century another difficulty presented itself. The distribution of the proceeds had led to much dissatisfaction on the part of places where the business enterprises were located; for the revenues went not to these localities, but to the places where the stockholders happened to reside. As the result of a long agitation the law was changed in 1910 so that in the case of ordinary business corporations, while the state still retained that part of the tax paid on account of the shares owned by non-residents, the remainder was distributed to the city or town where the business was carried on; and if the business was carried on in more than one city or town, the remainder was then distributed in proportion to the value of the tangible property of the corporation in each city or town. If, however, the business was not carried on in the state and if the corporation did not own any tangible property in the state other than ordinary office furniture, the tax was retained by the state.

The corporate excess tax on business corporations was again altered in 1919, being applied now to foreign business corporations as well. Some changes were made in the items deducted from the value of the capital stock, and the tax became a flat tax of $5 per thousand. Finally in addition to this corporate excess tax all corporations were subjected to an income tax of two and a half per cent, with complicated provisions as to allocation.

The Massachusetts system of taxing the corporate excess

at present may therefore may be summed up as follows. Corporations are divided into four classes: ordinary commercial and manufacturing companies; street railroads; other public-service corporations; and financial corporations.

(1) Ordinary business companies may deduct from the appraised value of the capital stock: (a) the value of the equity, exclusive of any mortgage, of the real estate and machinery locally taxed within the state; (b) the value of the property, over and above any mortgage, situated in another state or country; (c) the value of securities, the income of which if owned by a natural person resident in Massachusetts would not be taxable; and (d) a proportionate share of the accounts and bills receivable. The tax is distributed to the localities in accordance with the ratio of the tangible property in the town or towns where the business is carried on, except that the state retains that part of the tax paid on account of shares owned by non-residents.

(2) Street railways may deduct from the value of the capital stock: (a) the value of the real estate and machinery taxable locally, and (b) the value of so much of the capital stock as is proportional to the line outside of the state. The proceeds are then distributed to the localities in accordance with relative trackage, the state retaining practically nothing. In the case of electric roads only so much as corresponds to trackage on public highways is so distributed.

(3) Other public-service corporations in general, are allowed the same deductions as street railways, but the proceeds are distributed according to the residence of the stockholders. In the case of domestic telephone companies, however, instead of deducting so much of the stock as is proportional to mileage outside of the state, the law prescribes a deduction of so much of the stock as is owned by the companies in other corporations, when the tax is paid. In the case of foreign telephone companies, in lieu of this there is deducted so much of the capital stock as is proportionate to the number of telephones used or controlled outside of the state.

(4) Financial corporations subject to the law include only trust companies and stock insurance companies. For banks, savings banks and mutual insurance companies are, as we know, taxable under different laws. Financial corporations pay the excise tax on all personal property held in trust. But as they are permitted to deduct the value of real estate and as mortgages

are in Massachusetts considered an interest in real estate,[1] they may deduct all their loans on real estate and thus virtually escape taxation on this account. They are, however, further taxable on their deposits (except demand deposits) at a rate equal to three-quarters of the rate on the corporate excess. This means virtually a rate of about 1% on deposits,—double that on savings banks.

The Massachusetts system is therefore a complicated, but effective one.[2] The chief criticism to be urged—namely, the failure to take account of corporate bonds in estimating the value of the capital—is somewhat attenuated by the fact that in Massachusetts, to a far greater extent than anywhere else, railroads as well as other corporations have been created on the proceeds of share capital alone. The other criticism, however, that the tax applies only to domestic companies has been removed by the law of 1919.

The corporate-excess method of taxation has recently been extended to California, but with improvements. In California the law of 1910, which as we know[3] was designed to bring about a separation of state and local revenues, divided corporations into two classes—public-service and other corporations. All public-service corporations (except water companies) are taxed on the basis of gross receipts, according to the rates

[1] *Cf. supra*, p. 104.

[2] Among the more important literature of the subject we may mention: James R. Carrett, "Taxation of Franchises in Massachusetts" in *Municipal Affairs*, vol. iv., p. 506; F. A. Wood, "The Massachusetts Franchise Tax and Local Distribution," *ibid.*, p. 124; J. P. Procter, *Additional Burdens upon Street Railway Companies*, Boston, 1891; Whitney and Cummings, *Additional Burdens upon Street Railway Companies*, Boston, 1891; E. W. Burdett, *Argument for the Massachusetts Street Railway Association*, Boston, 1893; S. J. Elder, *Special Taxation for the Use of the Streets*, Boston, 1897; F. A. North, *Business Corporations in Massachusetts*, Boston, 1903; H. Winn, *The Corporation Exemptions of 1903*, Boston, 1905; A. E. Pillsbury, *Argument for the Association of Massachusetts Gas Companies*, Boston, 1903; J. M. Hallowell, *The Corporation Franchise Tax*, Boston, 1904; G. Calkins, "The Massachusetts Business Corporation Law," in Ripley's *Trusts, Pools and Corporations*, 1907; J. M. Hallowell, *The Taxation of Domestic Manufacturing Corporations in Massachusetts*, 1908; C. A. Andrews, "Taxation of Corporate Franchises in Massachusetts," in the *Yale Review*, Feb., 1911, p. 353 *et seq.*; *The New Massachusetts Business Corporation Excise Tax*. Pub. by the First National Bank of Boston, 1919. *Cf.* the book by Friedman and the article by Bullock mentioned *supra* on pp. 142 and 143. Much material will also be found in the numerous official reports on taxation.

[3] *Cf. infra*, chap. xi.

mentioned in the preceding section, and the taxes are expressly declared to be taxes upon the property and the franchise. All other corporations, including mercantile, manufacturing and mining companies (except insurance companies and banks which are separately taxed) pay a state tax on the so-called franchise. This is however virtually a tax on the corporate excess. For the value of the franchise is held to be the aggregate value of the stock and bonds less the value of the tangible property locally taxable. On this franchise, so determined a rate of 1% is imposed.

In this new system several points are to be noticed. In the first place, the definition of the franchise includes all the three varieties of franchises, which we shall discuss later.[1] In the second place, a peculiar provision is inserted into the law, requiring in the case of ordinary corporations the deduction of the value of the good will in estimating the value of the franchise. Thirdly, bonds as well as stock are considered in ascertaining the value of the franchise. Fourthly, in the case of public-service corporations the tax on gross receipts is in lieu of all other taxes except the local tax on real estate, the state corporation license tax and such municipal charges as may be imposed for any special privilege or franchise. Fifthly, in the case of other corporations in general the only difference theoretically is that the franchise is determined and taxed by the state instead of by the locality, the remainder of the property still being subject to local taxation. Practically, however, it means that the tax is now really assessed, whereas formerly it was apt to be left in abeyance. It may also be mentioned that, evidently by some oversight, in addition to the franchise tax there is still left in California the old annual license tax of $20 on all corporations.

In New Jersey, the tax on "miscellaneous corporations" dates from 1884, and is described as a "license for the corporate franchise." As amended in 1892, it applies to all corporations except railroads and canals (both of which are taxed separately), banks, cemeteries, religious, charitable or educational associations, and manufacturing or mining companies at least fifty per cent of whose outstanding capital is invested in business in the state. If the latter have less than fifty per cent of their capital so invested, they pay the tax on capital stock mentioned

[1] *Cf. infra*, chap. vii, sec. i.

below, but may deduct the assessed value of the property so used in manufacture or mining. Telegraph, telephone, cable, express, parlor car, gas, electric light, insurance, oil and pipe-line companies, as we have seen above, are taxed under this law in a special manner, *i.e.* on receipts, premiums and dividends. All other companies included under the head "miscellaneous corporations," pay a yearly "license fee" or "franchise tax" of one-tenth of one per cent on the capital stock issued and outstanding up to three million dollars; one-twentieth of one per cent on the capital between three and five millions; and fifty dollars additional for each one million dollars capital in excess of five millions. This tax applies, except in the case of insurance companies, only to domestic corporations. But it is to be borne in mind that railroad companies are not included in this tax on miscellaneous corporations.

In Rhode Island corporations were not separately taxed until 1912. The new law also makes a distinction between public-service and other corporations. Public-service corporations are taxed on gross receipts, as explained in the previous section; but the system differs from that of California in that the rate is low and in that not only real estate but also the tangible personalty continues to be liable for taxation to the general property tax. The gross earnings tax therefore simply takes the place of the tax on intangible personalty. Other corporations—*i.e.* manufacturing, mercantile and miscellaneous corporations, wherever incorporated—pay a tax at the low rate of 4 mills on the dollar on the corporate excess, which is determined as follows: The value of all bonds and of all other indebtedness is added to the value of the stock. In the case of corporations doing a business outside of the state, only a portion of the value of the stock is taken: where they derive their profit chiefly from the sale or use of real estate or tangible personalty, the proportion taken is the ratio of the value of such property in the state to the value of all such property in and out of the state; if, on the other hand, the profits are derived chiefly from the holding or sale of intangible property, the criterion is the relative proportion of gross receipts in the state to total gross receipts. In any other case in which, as the law reads, "these proportions are not equitably applicable" the officials are to take "such proportion as is equitable." From the total value of stock and debts thus ascertained is deducted the assessed value of the realty and tangible person-

alty located in the state. The remainder is pronounced to be the value of the corporate excess.

To these six states with general corporation taxes—Pennsylvania, New York, Massachusetts, California, New Jersey and Rhode Island—there might be added Maryland. In Maryland, the "tax on incorporated institutions" dates from 1841, when all domestic corporations were required to pay on the stock owned by non-residents (and after 1842 by residents), the state property tax. The county tax was still collected from the shareholder. In 1878 the present method was introduced, and the office of tax commissioner created. The tax is levied on the capital stock, or, if there be none, on the property and assets of all corporations, except steam railroads and savings institutions, both of which are taxed separately. Deductions are made from this valuation for the real property, for the capital invested in taxable property, for the non-taxable securities held and, in the case of building associations, for mortgages on taxable property. The corporations pay on only so much of the stock as is owned by residents. They were also required to pay, under a law of 1847, a locally assessed tax on bonds owned by residents. In 1896, however, bonds were made taxable to the owners at a rate of 3 mills, in addition to the general state rate. The corporation taxes in Maryland, therefore, now have only a very limited scope.

An interesting recent development is the adoption of corporate income taxes, now (1921) found in ten states. Wisconsin led the way in 1911 by a 2%–6% tax, as a part of the general income tax. Connecticut followed in 1915 with a 2% tax on business corporations. In neither of these cases were public utilities included. Virginia had for a few years subsequent to 1843 a tax on dividends. During the Civil War, again, a tax was imposed on the capital of steamboat companies and "companies of a similar character." In 1916, however, the old personal income tax was extended to corporations (excepting public utilities) at the rate of 1% and in 1919 the rate was graduated from 1 to 2%. Alabama had for a short time after 1866 a tax on dividends. There was formerly also a tax on the incomes of corporation; but this was abolished in 1884. In 1919, however, a general income tax law was enacted, applicable to corporations as well as individuals, but in 1920 the law was declared unconstitutional. The corporate income taxes first levied by New York in 1917 and Massachusetts in 1919 have been mentioned

above. In neither case were public utilities included; although Massachusetts has now for three successive years (1919–1921) included public utilities by a special law from year to year. All corporations were included in the general income tax by Missouri in 1917 at ½ of 1% (increased in 1919 to 1½%) and by North Dakota in 1919 at 3%; and in the same year Montana subjected all corporations to a "license fee" of 1% on net income. Finally in 1921, the income tax of Mississippi, levied on individuals in 1912 at the rate of ½ of 1% was declared by the courts applicable to all corporations; and North Carolina in 1921, imposed a tax of 3% on the net income of all corporations doing business in the state. On the other hand the general income tax of New Mexico of 1919 was repealed in 1920, and the special excise tax on public utilities of West Virginia of 1920 was abandoned in 1921.

In addition to these fourteen—or including Maryland fifteen—states with a general corporation tax on either capital or income we find many commonwealths which impose a slight tax, almost in the nature of fees. In a certain sense these may also be called general corporation taxes. They differ, however, from the corporation taxes hitherto discussed in three respects. In the first place, they are in almost every case not substitutes for, but supplemental to, the general property tax. Secondly, with one or two exceptions, the charge is fixed or graduated at specific sums instead of being a percentage tax. In the third place, the amount is so insignificant as scarcely to warrant the name of tax. In some cases the charge is even known as a fee, although the appellations are very varied. In ten states—Alabama, Arkansas, California, Colorado, Georgia, Kentucky, Oregon, Utah, Vermont and West Virginia—it is called a license or annual license tax. In ten states—Delaware, Kentucky, Maine, Michigan, Missouri, North Carolina, Ohio, Texas, Virginia and Washington—it is called a franchise tax. In Nebraska it is called an annual occupation fee. In Oklahoma it is called a "license tax or license fee." In Kentucky there is both a license tax and a franchise tax, the former being imposed on all corporations, the latter being payable in addition by public utilities. In California, as we noted above, the license tax is payable in addition to the new general franchise tax. In most of the above states the license tax is supplemental to the ordinary property tax; and in several of these states, as we learned in the last section, there are additional taxes on certain

classes of corporations. The character and rate of these license, or so-called franchise, taxes are as follows:

In Alabama the "license tax," imposed on all corporations, domestic and foreign, as a part of the general privilege tax system, varies from $10 if the capital is under $10,000 to $500 if the capital is over one million dollars. In Arkansas the "franchise tax" is at the rate of 1–20 of 1% upon the proportion of the subscribed or issued and outstanding capital stock employed within the state. In California the "license tax" is at the flat rate of $20. In Colorado the "license tax" on domestic corporations is 2 cents for each $1,000 if the capital is $25,000 or over. In the case of foreign corporations the tax is imposed on only so much of the capital stock as is employed within the state. In Delaware, where as we know public-service corporations as well as insurance companies and banks are separately taxed, all other corporations, *i. e.*, all manufacturing, mining, mercantile and miscellaneous corporations with less than 50% of capital invested in business carried on in the state, or whose capital is invested wholly without the state, are subject to an "annual franchise tax" on capital stock, ranging from $5, where the capital is under $25,000, to $50 where it is a million dollars, with an additional $25 for every succeeding million dollars. In Georgia the "annual license tax" is graded from $5 to $100. In Kentucky the "license tax" is 30 cents on each $1,000 of capital. In Maine the "annual franchise tax" is graded from $5 to $50 where the capital exceeds a million dollars, with $25 additional for each succeeding million dollars. In Michigan it is fixed at 3½ mills on each dollar of paid up capital and surplus, the minimum being $50, the maximum $10,000. In Missouri the rate in 1917 was 3/40 of 1%, increased in 1919 to 1/10 of 1% on the par value of the capital stock and surplus. In Nebraska the "occupation fee" varies from $5 to $200 if the capital exceeds two millions.

In North Carolina and Ohio the tax is 1–10 of 1% on the capital. In Oklahoma the "license tax or fee," which does not apply to public-service, insurance, banking or building and loan associations, is in the case of domestic corporations ½ of 1 per mill of authorized capital stock, and in the case of foreign corporations one per mill of the capital stock employed in business done within the state. The tax, however, is in no case payable on that part of the capital employed in any business subject to the "production, income or gross receipts tax." In

Oregon the "license tax" is graded from $10 to $200 where the capital is over two millions. South Carolina imposes a "license tax" of one-half per mill on all corporations except those public-service corporations which pay three mills. In Texas domestic companies pay 50 cents on each $1,000 of authorized capital stock up to 1 million dollars and 25 cents on each $1,000 thereafter. If the amount of capital stock actually paid plus surplus and undivided profits exceeds the authorized capital stock, the tax is to be computed on the former. If it does business without the state, the tax is proportioned to gross receipts. Foreign companies pay 1 mill up to $1,000; ½ mill to $100,000 and ¼ mill to a million dollars of the authorized capital stock, proportioned as in the preceding sentence. In Utah the "license tax" on all domestic corporations (except those not organized for profit, water companies for culinary purposes, canal and irrigation companies and insurance companies) and on all foreign corporations is graded from $5 to $50 when the capital stock is over $200,000. Virginia levies a small "license tax." In Vermont the "license tax" is $10 with $5 additional for every succeeding $50,000 until the tax reaches $50.

In Washington the "franchise tax" is fixed at $15. In West Virginia domestic companies pay a "license tax" graded from $10 to $150 from $500,000 to a million dollars; and $40 on each million dollars additional. In the case of non-resident domestic companies $475 and 10 cents on each additional $1,000 from two to four millions; over four millions, $675 and $50 on each additional $1,000.

The most recent development is in connection with the growing practice of issuing shares without par value. In some cases as in Missouri and New York each such share is deemed equivalent for purposes of taxation, to $100. In other cases as in Michigan its value is determined by actual sale or by book value. In still other cases the franchise tax is at a flat rate as in Maine (5 mills).

Outside of the few commonwealths which levy a general corporation tax at a special rate, almost all the states, including those mentioned in the preceding list, tax the property of corporations in general precisely like that of individuals through the general property tax. Of recent years, however, some states have declared the franchise to be taxable property, to be assessed like other property. This is true of corporations in general in Illinois, Indiana, Kentucky, Michigan, Minnesota,

Missouri, Montana, Tennessee and Wyoming, which states are to be added to those mentioned above, where the license or other tax is called a payment for the franchise. Sometimes the corporate excess is specifically designated as property and is declared to be the excess of the value of the capital stock over that of the tangible realty and personalty. The corporate excess is specified in Alabama, Illinois, Indiana, Minnesota, Mississippi, Nebraska, North Carolina, North Dakota, South Dakota, Tennessee and Texas. In most of these cases, however, the corporate excess is taxable by the local assessors, which means in practice that it is generally not reached. In only a few of these cases, like Illinois, is the corporate excess appraised by a state board, and in that state the system does not apply to railroads, telegraph, telephone, banking and insurance companies which are separately reached, nor to companies for purely manufacturing purposes, for the mining or sale of coal, for printing, for publication of newspapers, or for the improving or breeding of stock. As we mentioned above,[1] this attempt to include the franchise in the value of the property really involves a partial departure from the general property tax. It will be more fully discussed below.

We see then that only in Massachusetts, Pennsylvania, New York, California and Rhode Island are there general corporation taxes, in the real sense of the term. To these states must now (1921) be added Connecticut, Mississippi, Missouri, Montana, North Carolina, North Dakota, Virginia and Wisconsin, because of their corporate income taxes, although the first and last do not include public utilities, and the others use the income tax only as a minor supplement to the property taxes. In Maryland the corporation tax is in reality levied almost exclusively on domestic companies. In New Jersey, the law applies in terms only to domestic corporations. Maryland and Pennsylvania are the only states which levy taxes on corporate bonds, although virtually only on the bonds of domestic corporations in the hands of residents. In California and Rhode Island, however, bonds are considered in arriving at the value of the franchise or of the corporate excess. Finally, only in Pennsylvania is the corporation tax in lieu of the local tax on personalty, while in California and Connecticut as well as in Pennsylvania the state tax on public-service corporations carries with it exemption from all local taxation.

[1] *Supra*, pp. 150 and 180.

6. *The Tax on Corporate Charters*

A mistake often made is that of confounding with the corporation tax what may be called the *tax on corporate charters.* This is in reality a license fee charged for the privilege of incorporation or of increasing the capital stock of a company, and it is generally either a lump sum, or a percentage of the amount of the capital stock. It is in most cases of very recent origin. In only a few states does it antedate the last decade of the nineteenth century and in only one or two is it found before 1870.

In Pennsylvania the earliest act is that of 1849, which provided that certain manufacturing companies on their incorporation should pay a bonus of ½ of 1% on the capital stock, payable in five annual instalments. In 1868 the rate was changed to ¼ of 1% but the tax bonus was extended to all corporations with a few exceptions, among which railroads were the most important. In 1889 the same rate was imposed on the authorized amount of all increases of capital stock. In 1897 the rate was increased to 1/3 of 1% on the authorized capital stock, with some exceptions which were still taxable at the old rate. In 1899 the rate was made uniform on all corporations at 1/3 of 1%, and the only corporations excepted from the bonus were building and loan associations and so-called corporations of the first class, *i. e.*, those incorporated by the courts, and usually not for profit. Railroads were therefore first included in this year. In 1901 the bonus was extended to foreign corporations also and was applied to so much of the capital as might be invested in the state after the date of the passage of the act.

In Massachusetts, where the charge is called an incorporation fee, the first law—that of 1863—simply imposed a fee of $1 for recording the certificate of incorporation. In 1865 this was increased to $5. In 1870 the charge was made a percentage one and the rate was fixed at 1–20 of 1% of the capital stock. In 1871 the minimum charge was fixed at $5 and the maximum at $200. This continued to be the law until 1903 when the charges were reduced, the rate being fixed at 1–40 of 1%, but with a minimum payment of §10.

At present the tax on corporate charters is found in almost all of the states, although under widely varying names. In Alabama and in Illinois, it is called "licence fees," in Connecti-

cut, it applies only to foreign corporations seeking a charter in the state, and is termed the "tax on corporate franchise," although quite unlike the franchise taxes in other commonwealths; in Kentucky, it is called the "tax on organization"; in Maine, the "tax on new corporations"; in Maryland, "bonus on corporations"; in Michigan the organization tax; in Missouri, the "corporation tax"; in Nebraska "occupation fee on corporations"; in New Hampshire, "charter fees"; in New Jersey, the "tax on certificates of incorporation"; in New York, the "organization of corporations tax"; in North Dakota the "corporate excise"; in Ohio, "organization fee"; in Oklahoma "incorporating fee"; in Pennsylvania and Rhode Island, "bonus on charters"; in Texas, "filing fees"; in Vermont, "corporation license tax"; in West Virginia, "license tax on charters and certificates of corporations."

The rates are flat rates; fixed percentage rates; graded rates, fixed in each grade; graded percentage rates; and graded rates, partly fixed and partly percentage.

The flat rates are found in seven states: $4 in West Virginia; $5 in Arizona and Oklahoma; $10 in South Dakota and Washington; $25 in Arkansas; and $100 in Florida.

The percentage rates are found in fourteen states as follows: 2 cents per $1,000 in Colorado and Tennessee; 15 cents per $1,000 in Nevada; 20 cents per $1,000 in New Jersey (with minor variations in detail); 25 cents per $1,000 in Utah; 1–20 of 1% (or 50 cents per $1,000) in Massachusetts, Michigan, New York (for domestic companies) and North Dakota; 3–20 of 1% in Ohio; 1–10 of 1% in Indiana, Kentucky and Rhode Island; 1/8 of 1% in Maryland and New York (foreign companies); 1/3 of 1% in Pennsylvania.

The graded rates, fixed in each class, are found in seven states: Alabama ($25 when the capital is not over $50,000, to $250 when the capital is over a million dollars); Georgia ($5 to $100); Idaho ($5 when the capital is not over $25,000 to $25 when the capital is over $500,000); Oregon ($10 to $100 when the capital is over two million dollars); Texas ($50 [except railroads, telegraph lines, street railways, express companies and channel or dock companies, which start at $200] to $2,500); Virginia ($25 to $5,000 when the capital is over ninety million dollars; but when companies are incorporated under a general, instead of a special, act the rates are lower, ranging from $15 to a maximum of $600); Vermont ($10 to $50).

The graded percentage rates are found in four states as follows: Connecticut (50 cents per $1,000 where the capital is not over five millions, and 10 cents per $1,000 above that); Kansas (1–10 of 1% on the first $100,000 of capital, 1–20 of 1% on the next $400,000 and $200 for each million or fraction thereof above $500,000 of capital); Montana (50 cents per $1,000 where the capital is not over one million dollars, and 25 cents per $1,000 above that); and South Carolina (one mill on each dollar up to $100,000 of capital, ½ mill from $100,000 to a million dollars, and ¼ mill on each dollar of capital over a million dollars).

The mixed graded rates, partly fixed and partly percentage, are found in nine states as follows: Colorado ($20 if the capital is not over $50,000, and 20 cents on each additional $1,000); Delaware (the same as Colorado); Illinois ($30 where the capital is not over $2,500, $50 if not over $5,000, and $1 for each additional $1,000); Iowa ($25 plus $1 on each $1,000 where the capital is over $10,000); Minnesota ($50 for the first $50,000 of capital, $5 for every additional $10,000); Mississippi ($20 where the capital is not over $10,000, $40 to $60 where the capital ranges from $10–$50,000, and 1–10 of 1% where the capital is $50,000 and over); Nebraska ($10 and in addition 10 cents per $1,000 where the capital is over one million dollars) and Wyoming ($5 where the capital is not over $5,000, $10 on capital between $5–$10,000, and 5 cents on each additional $1,000).

In four states—Maine, New Hampshire, New Mexico and Wisconsin—there is a very complicated system, the rates varying with different classes.

In eleven states—Alabama, Kentucky, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, Virginia and Wyoming—the rates are payable also on a subsequent increase of the capital stock.

In many of the above states the tax is now levied on foreign as well as on domestic corporations; while some states follow New York in imposing the tax also on joint-stock companies.

The modifications introduced into the organization tax as a result of the recent development of shares without par value are analogous to those referred to above [1] in connection with the franchise tax.

These taxes have really little in common with the corporation taxes properly so called. In Pennsylvania and Ohio, for instance, the payment is held to be not a tax at all, but a price

[1] *Supra*, p. 213.

paid for the chartered privilege. The distinction between the tax on corporate charters and the corporation tax proper can, perhaps, best be expressed by saying that if the latter is a tax on the right to be, the former is a tax on the right to become.

III. *Bases of the Tax*

The summary just presented shows the chaos of principle in which the whole subject is involved. An analysis of the facts discloses no less than thirteen important methods of taxing corporations, not counting the various combinations of method which are practised in some states. The bases on which the taxes are assessed are as follows:—

1. *Value of the property, i. e.*, the realty plus the visible and invisible personalty. This was originally the universal method and it is still the practice in the great majority of cases.

2. *Cost of the property.* This was the general rule in New Jersey from 1873 to 1876 as to all railroad companies, and is still the rule in isolated cases, as in New York in the local taxation of telegraph companies.

3. *Capital stock at par value.* This is true of the general corporation law in New Jersey, of mining companies in Massachusetts, and of banks and savings institutions in Pennsylvania.

4. *Capital stock at market value.* This is true of the general corporation law in Massachusetts and in New York when applied to corporations where the dividends are less than six per cent. It was true of railroads in Connecticut between 1849 and 1864. It is also the custom in local taxation in many states.

5. *Capital stock plus bonded debt at market value.* This is true of all corporations in Pennsylvania and of railroads in Georgia and in Illinois. In the case of railroads in New Jersey and of corporations in general in Illinois and several other states, only the surplus of this valuation over the value of the tangible property is made the basis of the tax.

6. *Capital stock plus total debt, both funded and floating.* This is true of railroads in Connecticut, and in a measure true of corporations in general in California and Rhode Island. It was true of steamboat companies and of similar corporations in Virginia during the Civil War.

7. *Bonded debt or loans.* This was true of railroads and canals in Virginia from 1872 to 1874, and is now true of all

corporations in Pennsylvania. In this case, however, it is only supplementary to the tax on capital stock.

8. *Business transacted.* This is true in several of the New England states of savings banks taxed on their deposits; in California, Maine and New York of foreign banks; in New Hampshire and Vermont of trust companies taxed on deposits; in Connecticut and Massachusetts of insurance companies taxed on the amount insured; in Montana of telegraph companies taxed on the instruments; in Connecticut, Florida, Montana and Tennessee of telephone companies taxed on the number of telephone transmitters; in several Southern states of sleeping-car companies taxed according to the number and mileage of cars; in Delaware of railroads taxed on the number of locomotives and passengers. It was also true in Pennsylvania from 1868 to 1874 of railroads; from 1868 to 1881, of coal companies taxed on tonnage; and from 1870 to 1889 of boom companies taxed on the number of logs rafted.

9. *Gross earnings.* This is true in many states of insurance companies taxed on gross premiums, and of transportation and other public-service companies taxed on gross receipts.

10. *Dividends.* This is true of gas and electric light companies in Delaware, New Jersey and New York, and of turnpike companies in Kentucky. It was formerly true of banks and iron companies in Pennsylvania, and of banks and insurance companies in Ohio and Virginia and of corporations in general in Alabama.

11. *Capital stock according to dividends.* This is true in New York of corporations not subject to income tax, when dividends are at least six per cent. It was formerly true of banks in North Carolina and of all corporations in Pennsylvania.

12. *Net earnings or income.* This is true of railroads in Delaware; of street railroads in Massachusetts and Rhode Island; of insurance companies in a number of states; and of corporations in general in those states which like Connecticut, Massachusetts, Mississippi, Missouri, Montana, New York, North Dakota and Virginia now impose corporate income taxes.

13. *Franchise.* This is true of a large number of cases; but the term *franchise*, as we shall see, denotes nothing definite, and the value of the franchise is measured by each one of the preceding twelve tests except that of property.

All the above methods may really be reduced to three: taxes on property (nos. 1–7 and 11); taxes on business (no. 8); and

taxes on earnings (nos. 9, 10 and 12). Virtually, as we shall see, the choice lies between taxes on property and taxes on earnings.

From this survey of the existing confusion, it is plain that we are still groping in the dark and that no one method has yet pre-eminently commended itself to the American sense of justice and expediency. In the next chapter we shall learn the judicial interpretation put upon these various methods, and shall attempt to analyze the situation from the economic point of view. That some change is imperative seems evident; precisely what the change should be can be ascertained only after careful consideration. It is a complicated problem that confronts us.

CHAPTER VII

THE TAXATION OF CORPORATIONS

II

THE PRINCIPLES

In the preceding chapter we traced the history and actual condition of the corporation tax in the United States. The whole subject was shown to be involved in almost inextricable confusion, amid which, however, some twelve different bases for levying the tax might be distinguished. These, it will be remembered, were the value of the property, capital stock at par value, capital stock at market value, capital stock plus bonded debt, capital stock plus total debt, loans, business, gross earnings, dividends, capital stock according to dividends, net earnings and franchise. In the attempt to analyze these methods it may be well to begin with the last, on account of its obscurity as well as of its importance.

I. *The Franchise Tax*

At the outset we are confronted by the question: what is a franchise tax? The matter was first brought squarely before the public by the provisions of the California constitution of 1879, and since then by tax laws of several states which prescribe that franchises of corporations shall be separately assessed. Before we can discuss the franchise tax, however, we must attempt to ascertain what a franchise really is.

Blackstone defines a franchise as "a royal privilege or branch of the King's prerogative subsisting in the hands of a subject." His definition is obviously too vague for our purposes. The Supreme Court of the United States has given this definition:

> A franchise is a right, privilege or power of public concern which ought not to be exercised by private individuals at their mere will and pleasure, but which should be reserved for public control and administration, either by the government directly or by public agents acting

under such conditions and regulations as the government may impose in the public interest and for the public security.[1]

This definition, however, is somewhat too narrow, since it emphasizes unduly the element of public control and public interest. These are indeed very desirable adjuncts, but they scarcely seem to be indispensable parts of the conception. Nothing is more common than the possession by a purely private corporation of a franchise—for example, the mere privilege to act as a corporation. Furthermore, a privilege of a public character, like that possessed by a railway, is not necessarily confined to corporations. Thus, there is nothing to prevent the grant of the right of eminent domain to private persons. We therefore conclude that a franchise in the wider sense is simply a right conferred by government of conducting an occupation either in a particular way or accompanied with particular privileges. The motive may be either public welfare or public revenue. This can be clearly seen by tracing the historical development of the franchise.

One of the chief sources of royal income in mediæval Europe consisted in the so-called "fines for licenses, concessions, and franchises." These were payments by individuals or associations for all kinds of special privileges, such as to secure the general favor of the crown, to retain or to quit office, to obtain the right of exporting commodities, to conduct some business in a particular way, to obtain special jurisdictional privileges, to possess the right of *firma burgi*, and so on.[2] A most common instance can be found in the trading privileges of the guilds, granted chiefly for the sake of the accruing emoluments. Similar to these mediæval concessions are the modern licenses, especially in the Southern commonwealths, which are conferred on individuals and corporations alike, and in most cases for purely fiscal reasons. What are called franchise taxes elsewhere are included in the South in the privilege or occupation taxes. A franchise of an individual or of a corporation is, therefore, simply a privilege—something over and above the value of the property, and in a measure analogous to the "good will"

[1] California *vs.* Southern Pacific R. R. Co., 127 U. S. 40.

[2] A characteristic example of a fine or franchise hard to classify is this: The wife of Hugo de Neville paid the king two hundred hens "eo quod possit jacere una nocte cum domino suo" (who happened to be in prison). *Rotuli Finium*, 6; quoted in Madox, *History of the Exchequer*, i., p. 471.

of a firm. It is the indefinite something which gives vitality to the enterprise and makes its business worth having.

In the case of a corporation this indefinite something is the privilege that individuals possess to act as one, with legal individuality and immortality, and with divisible share capital. This is a privilege which corporations share equally with joint-stock companies; accordingly, the corporation tax is frequently made applicable to such associations. A modern stock corporation indeed possesses another privilege, which is exclusive to it, namely, limited liability. The corporate franchise therefore is really the privilege of juristic personality and limited liability; it is the right to exist as a corporation.[1] Since it is something separate and apart from the property of the corporation, it is capable of being taxed.[2]

What has been said applies, however, only to domestic corporations. In the case of a foreign corporation, the state which has not given the franchise cannot tax it. With a domestic corporation the franchise or right to exist is an empty right if the corporation may not transact business; the right to exist is therefore inextricably bound up with the right to carry on the business. But as regards a foreign corporation, the two things are distinct, and the state can tax only the privilege of carrying on the business within its borders. The corporate franchise has no existence apart from the laws of the state which created it. In order to avoid trouble, therefore, the corporation tax is usually imposed on "the corporate franchise or business;" and the New York tax has been upheld as applicable to foreign corporations as a tax on their business, not on their franchise.[3]

The denial of the right to tax the franchises of foreign corporations applies equally to corporations chartered by the United States which are not legally foreign corporations. But where the corporation, as in the case of a railroad, exercises

[1] "By the term *corporate franchise* we understand is meant the right or privilege given by the state to two or more persons of being a corporation, that is, of doing business in a corporate capacity." Home Insurance Co. *vs.* State of New York, 134 U. S. 594. *Cf.* Western Union Telegraph Co. *vs.* Mayer, 28 Ohio State, 521.

[2] "Nothing is better settled than that the franchise of a private corporation . . . is property and of the most valuable kind, as it cannot be taken for public use without compensation." Wilmington R. R. Co. *vs.* Reed, 13 Wall. 264, 268.

[3] People *vs.* Equitable Trust Co. of New London, Conn., 96 N. Y. 396.

additional privileges in the state, it is held that it enjoys a state franchise as well as a federal franchise and that a state tax may be imposed on the former franchise without being an attack upon the privilege granted by the federal government.[1] This, however, does not apply to national banks which cannot be subjected to license or privilege taxes.[2] Some recent cases in Pennsylvania have even held that the tax on capital stock is invalid as to stock invested in a patent right, because such taxation involves a property right which depends for its existence exclusively on the federal constitution and on an act of Congress.[3] This seems to be an extreme application of the general principle which, if persisted in, will render a great part of our corporation tax laws practically nugatory. For almost every corporation utilizes something covered by a patent; and if it is held that the capital stock represents in whole or in part this patented property, the corporation would to that extent escape taxation. Later decisions in other states, like New York and Maryland, seem to take the proper view. For in New York it has been held that even if the entire capital of a corporation is invested in patent rights, it is none the less subject to the capital stock tax.[4] And the same rule has been extended to trade-marks.[5]

Subject to these qualifications and to the principle, to be discussed below, that no commonwealth may impose a franchise tax to interfere with interstate commerce, the taxation of corporate franchise has no limitation, except the discretion of the taxing power.[6]

The franchise that has been discussed thus far is the privilege of doing business. When, however, we analyze a little more closely the concept of a corporate franchise we see that there are other aspects to the problem. In order to do business, the

[1] People *vs.* Central Pacific R. R. Co., 105 Cal. 576; and California *vs.* Pacific Railroad Companies, 127 U. S. 1.

[2] Mayor *vs.* National Bank of Macon, 59 Ga. 648; City of Carthage *vs.* Bank of Carthage, 71 Mo. 508; National Bank of Chattanooga *vs.* Mayor, 8 Heiskell, 814.

[3] Commonwealth *vs.* Westinghouse Co., 151 Pa. State, 265; Commonwealth *vs.* Air Brake Co., *id.* 265; Commonwealth *vs.* Philadelphia Co., 157 Pa. 527; Commonwealth *vs.* Lehigh C. and I. Co., 162 Pa. State, 603.

[4] People *ex rel.* U. S. Aluminum Plate Co. *vs.* Knight, 174 N. Y. 475 (1903); Crown Cork and Seal Co. *vs.* State, 87 Md. 687.

[5] People *ex rel.* Spencerian Pen Co. *vs.* Kelsey, 105 App. Div. 133 (1905).

[6] Delaware Railroad Tax Case, 18 Wall. 231; California *vs.* Southern Pacific R. R. Co., 127 U. S. 41.

corporation must first come into being; and even after the corporation has been created, it does not necessarily follow that it will do business. Consequently we must distinguish between the creation of a corporation and the exercise of its powers. If the latter is termed the franchise to do or to act, the former might be called the franchise to be or to become. For this privilege to be, as we have learned, virtually all the states make a charge; and while ordinarily called a fee, it is not infrequently termed a franchise tax.

In addition to the franchise to be and the franchise to do, there is, however, still a third kind of franchise, which it has become usual of recent years to call a special franchise. This is the right accorded to certain corporations to possess privileges not enjoyed by corporations in general. The most important of such special privileges is the right to use public highways, and it is for this reason that the corporations enjoying this right are generally called public-service corporations. This special franchise was first brought into prominence in New York. In that state it is permissible to deduct debts from personalty, but not from real estate. It was accordingly easy for corporations to escape taxation on their capital, which as we know is still locally taxable in New York. For when the bonded indebtedness exceeded the capital stock, there would be nothing left on which to levy the tax except the real estate. When an attempt was made later to assess the value of the franchise over and above that of the personal property, the attempt was frustrated by the same facility of deducting the value of the bonds. Hence an ingenious plan was devised. A franchise in general, if it be any kind of property, is personal property. But it was now suggested that a franchise enjoyed by some corporations only, to use the streets, on the surface or above or below the level, might properly be termed an interest in real estate; and if so, there could not, under the New York system, be any set-off on account of mortgage bonds. Accordingly by the law of 1899 a new category of real estate was created in New York, to be known as a special franchise. The law added to the definition of taxable real property the following:—

"The value of all franchises, rights or permission to construct, maintain or operate the same [surface, underground or elevated railroads] in, under, above, on or through streets, highways or public places; . . . and the value of all franchises, rights, authority or permission to construct, maintain or operate in, under, above, upon, or through any

streets, highways or public places, any mains, pipes, tanks, conduits or wires, with their appurtenances, for conducting water, steam, heat, light, power, gas, oil or other substance, or electricity for telegraphic, telephonic or other purposes. . . . A franchise, right, authority or permission specified in this subdivision shall for the purposes of taxation be known as a 'special franchise.'" A special franchise shall be deemed to include the value of the tangible property situated in, upon under or above any street, highway, public place or public waters in connection with the special franchise in 1907.[1]

Under this ingenious definition of a special franchise all public-service corporations in New York have now been compelled to bear a far greater burden of taxation than was previously the case.[2]

The new conception soon spread to other states, although in most cases the special franchise is either measured by a certain proportion of gross receipts as in New Jersey, or is treated as a separate constituent of property without any decision as to whether it is realty or personalty. Only a few states, like California, follow New York in treating the special franchise as an interest in real estate.

Thus we see that there are now in the American system of corporate taxation three kinds of franchises—the franchise to be, the franchise to do, and the franchise to act in a particular way or to enjoy a special privilege. It is interesting to observe that in the California law of 1911 all three species of franchises are included in the definition.[3]

[1] An amendment adopted later, provided that "the term 'special franchise' shall not be deemed to include the crossing of a street, highway or public place outside the limits of a city or incorporated village where such crossing is less than 250 feet in length, unless such crossing be the continuation of an occupancy of another street, highway or public place." Under this, in practice, ordinary railroad crossings were not treated as special franchises. But a later amendment, in 1907, made a steam railroad crossing in a city or village assessable as a special franchise. As special franchises are assessed by a state board, while ordinary real estate is assessed by local officials, this has caused much confusion in the actual administration. *Cf.* the interesting monograph by Benj. E. Hall, one of the New York State Tax Commissioners, *Administrative Difficulties of the Special Franchise Tax Law. Address before the State Conference on Taxation held at Utica*, Albany, 1911.

[2] *Cf.* Seligman, "The Franchise Tax Law in New York," in *Quarterly Journal of Economics*, vol. xiii. (1899), p. 445 *et seq.*

[3] "These franchises shall include the actual exercise of the right to be a corporation and to do business as a corporation, under the laws of this state and the actual exercise of the right to do business as a corporation in this state when such right is exercised by a corporation incorporated

It must further be observed, however,—although it is an observation that has hitherto eluded the attention of well-nigh all writers on the subject—that amid the multiplicity of meanings attached to the word franchise two leading ideas are discernible in its relation to taxation. We refer here not to the distinction just discussed between a franchise to be, a franchise to do, and a franchise to act in a particular way; but to the distinction between franchises based on their assumed relation to property. Here there are two fundamental conceptions. The one is the conception of a franchise as a part of property; the other is the conception of a franchise as something distinct from, or even opposed to, property. The first conception leads to the idea of a franchise tax as something of the same nature as a tax on physical, tangible property, but superadded to it. This is the case in all the states which include the value of the franchise in the *ad valorem* tax, as in Michigan, Wisconsin, Illinois, or even New York in the case of the special franchise tax. In all these cases the franchise tax is thought of as a property tax; but it is a tax on intangible property or on an intangible something of which the concept of property is predicated, whether in the eyes of the law it be treated as real property or as personal property. The other conception leads to the franchise tax as something distinct from, or opposed to, a property tax, as in the case of the capital stock tax in New York. Let us elucidate these conceptions.

If we take up first that conception of a franchise which leads to the franchise tax as a property tax, the question at once arises as to how the value of the franchise as a piece of taxable property is to be ascertained. It is obvious that here we are face to face with great difficulties.

We have seen that there are not less than twelve separate methods of taxing corporations and that each of these methods, with one exception, is declared to involve a franchise tax. There are yet other methods of measuring franchise, such as the value of the capital stock less the value of the property,

under the laws of any other state or country, also, the right, authority, privilege, or permission to maintain wharves, ferries, toll roads and toll bridges, and to construct, maintain or operate in, under, above, upon, through, or along any streets, highways, public places, or waters, any mains, pipes, canals, ditches, tanks, conduits, or other means for conducting water, oil, or other substances." Statutes of California, 1911, chap. 335. *Cf.* the article by Professor C. C. Plehn, "The Taxation of Franchises in California," in the *National Municipal Review*, vol. i. (1912), p. 337 *et seq.*

the value of the stock less the value of the tangible property, the value of the stock less the value of the realty, the value of the stock and bonds less each or all of these items, *etc.* There is a total lack of uniformity. Each commonwealth measures the franchises of its corporations in its own way; and frequently a given commonwealth measures the franchises of different corporations in entirely different ways. There is an utter absence of any common standard of measurement. Capital stock, stock minus property, stock minus realty, bonded debt, business, gross earnings, dividends, profits, *etc.*, are each declared to be the value of the franchise. The result is hopeless confusion. It would be useless to examine the methods of all the states; a few examples will suffice.

The state board of assessors of New Jersey have published since 1884 annual reports in which they discuss the details of corporate assessment. In the case of railroads they adopted the following plan.[1] The market value of the stock is added to the market value of the debt; from this aggregate the total value of the tangible corporate property is deducted, and the remainder is declared to be the "adventitious value of the entire road, its privileges included." Sixty per cent of this is taken as the value of the franchise, to which is added the value of the real and tangible property, known as the "abstract value" of the road, making a total which is termed the entire value of the railway for purposes of taxation. This, however, is not all; for if the value of the tangible property exceeds the value of the stock and debt, the board declares the franchise to be twenty per cent of the gross earnings. It will be readily perceived that this measurement of a franchise, which may give a result less than nothing, is rather awkward. Indeed, the courts of New Jersey have overturned this portion of the assessors' standard by pronouncing the estimate based on gross earnings unconstitutional;[2] but the main element in the method of valuation was upheld on the easy-going principle that no substantial injustice was done. It is this absence of "substantial injustice" to which is due the chaotic condition of franchise taxation in this country to-day.

[1] *Report of the State Board of Assessors of New Jersey*, 1884, p. 26; 1885, p. 11; 1886, p. 28; 1888, p. 6.

[2] Case of Railroad Tax Law, N. J. Court of Errors and Appeals, decided May 29, 1886. The case may be found in full in the *Third Annual Report of the State Board of Assessors*, 1886, pp. 79–173.

In Illinois and in California, the method of taxing franchises is not far different from that of New Jersey. In Illinois, the board of equalization adds the cash value of the stock to that of the debt (excluding current debt), and pronounces the result to be the fair cash value of the capital stock including the franchise. From this the board deducts the equalized value of all the tangible property, and declares the remainder to be the value of the capital stock and franchise subject to taxation. This method was upheld by the Supreme Court of the United States as being "probably as fair as any other." [1] In California, the value of the franchise is determined by subtracting from the actual value of the capital stock or of the stock and bonds the value of all the items of property.[2] In some cases only a fraction of the remainder is declared to be the value of the franchise. The only change introduced by the law of 1911 is that in the case of ordinary corporations, exclusive of public-service companies and banks, the good will is no longer to be included in the value of the franchise—a curious provision in view of the fact that in many corporations the good will of the business constitutes the major portion of the franchise value. In Kentucky, the assessors deduct from the amount of the capital stock the assessed value of all tangible property taxed in the state, and declare the remainder to be the value of the franchise. In the case of foreign companies, however, they take that proportion of the capital that the gross receipts in the state bear to the total gross receipts, and then deduct the value of the tangible property assessed in the state. In the case of transportation companies they take only that proportion of the capital stock which the length of the line within the state bears to the total length.[3] In Indiana, if the full value of the franchise is represented by the capital stock, the franchise is not taxed; but when the franchise is of greater value than the capital stock, it is provided that the franchise "shall be assessed at its full cash value," and that the capital stock shall not be taxed.[4]

[1] State Railroad Tax Cases, 2 Otto, 575. *Cf.* Railway *vs.* Backus, 154 U. S. 421.

[2] Approved as to public-service corporations in Spring Valley Water Works *vs.* Schottler, 62 Cal. 69, 118; Burke *vs.* Badlam, 57 Cal. 594; San José County *vs.* January, 57 Cal. 614; and as to corporations in general in Bank of California *vs.* San Francisco, 142 Cal. 276.

[3] Ky. Laws of 1892, chap. 102, art. iii., § 3.

[4] Ind. Law of Mar. 6, 1891, § 74; now R. S. 1908, § 10324.

Of considerable interest are the methods that have been employed by Michigan and Wisconsin, especially after the abandonment of the system of specific taxes on the earnings of public-service corporations and the reversion to the *ad valorem* system. In Michigan, after the passage of the law of 1901 which authorized the *ad valorem* system in the case of railroads, the appraisal of the so-called non-physical or immaterial elements in the value of a railroad was entrusted to Professor Henry C. Adams. We quote from his report:

"The rule submitted for the appraisal of the immaterial values of railway properties, or what I prefer to term the capitalization of corporate organization and business opportunity, is simple, as follows:

"1. Begin with gross earnings from operation, deduct therefrom the aggregate of operating expenses and the remainder may be termed the 'income from operation.' To this should be added 'income of corporate investments' giving a sum which may be termed 'total income,' and which represents the amount at the disposal of the corporation for the support of its capital, and for the determination of its annual surplus.

"2. Deduct from the above amount—that is to say 'total income' as an annuity properly chargeable to capital—a certain per cent of the appraised value of the physical properties.

"3. From this amount should be deducted rents paid for the lease of property operated and permanent improvements charged directly to income. The remainder would represent the surplus from the gross earnings from the year's operations, and for the purposes of this investigation may be accepted as an annuity which, when capitalized at a certain rate of interest, gives the true value of immaterial properties."

Professor Adams himself added that the above rule failed to appraise the speculative element in railway property.

As a matter of fact, however, this rule was applied only in part. It was soon realized that the calculation might easily result in a minus quantity. When this turned out to be the case, the awkwardness of the situation was relieved, in part at least, by entirely disregarding the non-physical element in the property, and taking only the valuation of the physical property. We are told that in only 26 of the 123 railroads appraised at the time was a non-physical value placed on them.[1]

[1] See the address by Robert H. Shields, a member of the Michigan State Board of Assessors, entitled, "Railroad Taxation Problems," in *Addresses and Proceedings of the Fourth Conference of the International Tax Association*. Columbus, 1911, p. 238.

At present, the method actually followed in Michigan, as in most of the other states which attempt to tax the franchise as a piece of property, is very different. The laws refrain from laying down any rule at all and leave the matter entirely to the discretion of the assessing body, which refuses to state in what its precise method consists. In California, *e.g.* the law of 1911 declared "franchises taxable at their actual cash value, in the manner to be provided by law." But the law simply placed the whole matter in the hands of the state board. As one of the Michigan assessors frankly stated, if the board were to reveal the grounds of their valuation, they would simply invite endless criticism and objection on the part of the corporations which they are required by law to assess.[1] It is an open secret, however, that the chief reliance of the Michigan board is upon earnings, so that the value of the franchise represents in great part a capitalization of earnings. In Wisconsin, again, while nothing definite is divulged, it is generally understood that the valuation is made by a combination of the "stock and bond method" with the "capitalization of earnings" method. But to what extent other criteria are actually taken into account, no one knows. Under such circumstances we are confronted by what is the chief objection to the whole method, namely, the danger of arbitrariness and the lack of any precise directions to guide the assessors or to enlighten the public. In such a complicated matter as that of appraising the value of a franchise, which has no market value because it is not the subject of purchase and sale, no two people, however expert, will agree. As one of the Michigan commissioners states: "When it comes to a question of the ultimate valuation, each member of the board has his own opinion." The result has been in Michigan as everywhere else, a sort of compromise which differs very materially from the valuation of the original experts.

It is clear from the above review that the attempt to tax the franchise as a piece of property is highly unsatisfactory. If the value of the franchise is measured by any one criterion such as earnings, or dividends, or stock and bonds, there is nothing gained by the attempt to differentiate a franchise tax from a tax on earnings or on dividends or on stock and bonds. If, on the other hand, an attempt is made to reach the capital value of the franchise by a method of appraisal, without resort to any specific

[1] See the admission in the *Report of the Ontario Commission on Railway Taxation*. Toronto 1905, p 48.

criterion, it becomes mere guess work. We may agree with the authors of the most discriminating of recent reports on the subject that when all factors contributing to value are supposed to be taken into account and when in this way the board of assessors entirely avoid the responsibility of saying how their ultimate assessment is made up, even assuming it to be known to themselves, such a "system obviously has the fatal defect of making it impossible either for the railroads or the general public to distinguish between the most accurate and conscientious valuation and mere ignorant guess work or quite prejudiced and even dishonest returns. Certainly one cannot imagine a more complete departure from the fundamental basis laid down by the [Michigan] tax commission for the administration of the new system." [1]

Such is the difficulty encountered in attempting to levy a tax on the franchise as a piece of property. As we saw above,[2] however, the other conception of a franchise tax is that not of a property tax, but of something different from a property tax. Let us now proceed to consider the meaning of this other kind of a franchise tax.

What is the real significance of the franchise tax in this broader sense? Why is it desirable that such a hard and fast line should be drawn between the property tax and the franchise tax? What is the meaning of the distinction?

The answer is very plain. In the first place, according to the constitutions of several of the states, the taxes on property must be uniform. If, however, the corporation tax is held to be a franchise tax, there is no necessity of such uniformity between the tax on individuals and that on corporations. Secondly, according to the principles of the property tax, deductions are allowed for certain classes of exempt or extra-territorial property. If the tax is a franchise tax, such exemptions cannot be claimed. Thirdly, if the tax is a franchise tax, and not a tax on property or earnings, it may be upheld as not interfering with interstate commerce. Finally, if the tax is a franchise tax, many of the objections to double taxation would, as we shall see later, be removed. Every commonwealth imposing a franchise tax, for instance, could assess the entire capital of a corporation,—or at all events of a domestic corporation—although only a very small portion might be located or employed within

[1] *Report of the Ontario Commission, etc.*, p. 53.
[2] *Supra*, p. 227.

the state. We can hence readily understand the persistence with which the corporations seek to uphold the distinction and to have the charge declared to be not a franchise, but a property tax.

The question has arisen almost exclusively in connection with the taxation of deposits, capital stock or earnings. In the case of deposits of savings banks the decisions are almost uniform that the tax is one on the franchise and not on the property;[1] among the few commonwealths that tax such deposits, Connecticut, Maine, Maryland and Massachusetts accept this view. Moreover, since there is no necessary relation between the amount of the deposits and the extent of the property, the tax is valid even if the deposits are invested in United States securities. Only one commonwealth, New Hampshire, has held out against the general tendency and pronounced the tax on deposits to be a property tax.[2]

In the case of capital stock the matter is more complicated and the decisions are more divergent. That capital stock is in one sense property will of course be denied by no one; but whether the tax on capital stock is tantamount to a tax on general property is an entirely different question. In several commonwealths it has been held that capital stock practically represents the property, and that the two are to all intents and purposes interchangeable terms.[3] As regards the tax on capital stock in general, other commonwealths, however, have decided, and the federal courts have affirmed the decision, that it is not a tax on the property. Thus, it has been held that the Delaware railroad tax of one-quarter of one per cent on the actual cash value of the capital stock is a tax not on the property or on the shares of individuals, but on the corporation, measured by a certain percentage on the value of its shares.[4] In like manner the Massachusetts taxes on the corporate excess, *i.e.* on the whole value of the corporate shares and on the capital stock in excess of the value of the real estate and machinery, have been

[1] Maryland *vs.* Central Savings Bank, 72 Md. 92; Coite *vs.* Society for Savings, 32 Conn. 173, affirmed in 6 Wall. 594; Provident Institution *vs.* Massachusetts, 8 Wall. 611. See also Commonwealth *vs.* Savings Bank, 123 Mass. 493; Jones *vs.* Savings Bank, 66 Me. 242.

[2] Bartlett *vs.* Carter, 59 N. H. 105.

[3] Jones *vs.* Davis, 3 Ohio, 474; Burke *vs.* Badlam, 57 Cal. 594; New Orleans *vs.* Canal Co., 29 La. A. R. 851; Whitney *vs.* Madison, 23 Ind. 331; County Commissioners *vs.* National Bank, 48 Md. 117. But see Wilkens *vs.* Baltimore, 103 Md. 293, reversing the former doctrine.

[4] The Delaware Railroad Tax Case, 18 Wall. 206.

pronounced taxes on the franchise.[1] In a later case it has been held that this tax, although nominally upon the shares of capital stock, is in effect a tax upon the organization on account of property owned or used by it, and therefore valid. It is an excise tax, not a property tax, and therefore not limited by the constitutional restrictions as to the uniform taxation of all property.[2] On the other hand, the Connecticut courts have held that the tax on capital stock and debt is a tax not on franchise, but on property; [3] and the older cases in Alabama and Missouri were similarly decided.[4]

Secondly, in the case of capital stock as measured by dividends, the courts of Pennsylvania and New York have arrived at diametrically opposite conclusions. In Pennsylvania a long series of cases has consistently maintained the doctrine that the tax is one on property.[5] The court has endeavored to lay down this rule:—

> "The test whether the tax in any given case is a franchise as distinguished from a property tax, would seem to be that a tax according to a valuation is a tax on property, whereas a tax imposed according to nominal value or measured by some standard of mere calculation—as contrasted with valuation—fixed by the law itself may be a franchise tax." [6]

The New York and New Jersey courts, on the other hand, have held the tax on capital stock to be a franchise tax.[7] The New York case was carried in last instance to the federal court. Of course the fact that the statutes of Massachusetts and New York expressly declared the tax to be a franchise tax was of no weight; for it was justly contended that no importance should attach to mere nomenclature. But the United States Supreme Court had already shown the tendency of its thought in the Massachusetts and Delaware decisions just cited. In a subse-

[1] Hamilton Co. *vs.* Massachusetts, 6 Wall. 632; Commonwealth *vs.* Hamilton Manufacturing Co., 94 Mass. 298; Manufacturers' Insurance Co. *vs.* Loud, 99 Mass. 146; Portland Bank *vs.* Apthorp, 12 Mass. 252 (1815), the basis of all subsequent decisions.

[2] Western Union Telegraph Co. *vs.* Massachusetts, 125 U. S. 530.

[3] Nichols *vs.* Railroad Co., 42 Conn. 103.

[4] State *vs.* Insurance Co., 89 Ala. 335; State *vs.* Railway Co., 37 Mo. 265.

[5] Fox's Appeal, 112 Pa. 359; Commonwealth *vs.* Standard Oil Co., 101 Pa. 119; Phœnix Iron Co. *vs.* Commonwealth, 59 Pa. 104; Catawissa Appeal, 78 Pa. 59.

[6] 101 Pa. 127.

[7] People *vs.* Home Insurance Co., 92 N. Y. 328; Singer Co. *vs.* Heppenheimer, 25 Vroom, 439.

quent case, the court said, although indeed *obiter*, that the New York tax was "a franchise tax in the nature of an income tax." [1] Finally, in a later case, the tax was definitely pronounced to be on franchise, the court holding that the tax was not upon the capital stock nor upon any bonds of the United States composing a part of that stock; but that reference was made to the capital stock and dividends only for the purpose of determining the amount of the tax to be exacted each year.[2]

This decision may be defended on economic, as well as on legal, grounds. It may be granted, and in fact it is difficult to dispute the contention, that the tax is in one sense a tax on capital stock. Nevertheless, it does not follow that the tax is a property tax; for from the economic point of view capital stock is not necessarily identical with the property of a corporation. In the first place there is the question of the market or par value of the stock. Some of the commonwealths, as we know, tax corporations on the amount, *i.e.* the par value, of the capital stock. Yet manifestly, where the market value of the stock may be double or half the par value, it cannot be maintained that the latter is identical with, or an index to, the value of the property. In no sense, therefore, can capital stock at its par value be declared equivalent to the whole property. Even if we take the market value of the stock, we are not in a much better position, for many of our corporations, especially railroads, are created on the proceeds of the bonds. In such cases, although the property may be great, the profits are devoted mainly to meeting the interest on the bonded debt, and since there may be no dividends, the value of the stock may be very slight. Yet the property which produces these profits may be enormous. Evidently the capital stock and the whole property are not identical. But we may go still farther. Even in the case of corporations without a bonded debt, but whose property does not pay good dividends, the capital stock at its market value is no index of the value of the property. Thus, a model-dwellings company may have property worth a million dollars; yet if it is so managed as to pay no dividends, the stock will sell in the market for a very small sum. The value of this depreciated stock is evidently not the same as that of the company's real property. They are not interchangeable terms. Hence, from

[1] Or, as it was said in another place, "a tax upon its franchise based upon its income." Mercantile Bank *vs.* New York, 121 U. S. 158, 160.

[2] Home Insurance Co. *vs.* State of New York, 134 U. S. 594.

whatever point of view we regard it, capital stock is not identical, economically speaking, with the total corporate property; a tax on capital stock is not a tax on the entire property.

The courts of New Jersey, New York and the United States are then quite right in their decisions; and the Pennsylvania cases seem to be incorrect both in law and in economics.

The third case in which the question of a franchise tax is of importance is in connection with the subject of interstate commerce. The growth of the interpretation put upon the principle that no state may levy a tax interfering with interstate commerce will be more fully discussed hereafter.[1] It may be stated here, however, that in a large number of cases it has been held that a tax on the franchise of a domestic corporation is valid even though the value of the franchise is measured by the gross receipts, a part of which are derived from interstate commerce.[2] Were the tax not a franchise tax, it might be invalid as a tax on interstate business.

It will be seen from the above review that the entire treatment of this kind of a franchise tax is based largely on a legal fiction. The conception is legal, not economic. It was devised by the legislatures and extended by the courts in order to evade the evil results of the general property tax.[3] It is remarkable that in the state of New York, where the commonwealth tax on capital stock is held to be a franchise tax, the local tax on capital stock, which is levied in almost the identical way, is held to be a property tax. In the local tax a deduction must be allowed for any non-taxable property in which the capital may be invested; in the state tax no such deduction is permitted.[4] Such a distinction is economically incorrect,

[1] *Infra*, pp. 264 *et seq*.

[2] State Tax on Railway Gross Receipts, 15 Wall. 284; Maine *vs*. Grand Trunk R. R. Co., 142 U. S. 217; People *vs*. Wemple, 117 N. Y. 136, and other cases cited below.

[3] This is apparent from the New York law of 1866, chap. 761, which declared the privileges and franchises of savings banks to be personal property, and taxable to an amount not exceeding the gross sum of the surplus earned. In Monroe County Savings Bank *vs*. City of Rochester, 37 N. Y. 365, the law was upheld, although the bank had a portion of its property invested in United States bonds. The court held that since the tax was upon a franchise it was unimportant in what manner the property of the corporation was invested. "The reference to property is made only to ascertain the value of the thing assessed."

[4] People *vs*. Barker, 139 N. Y. 55; People *vs*. Commissioners, 72 Hun, 126; People *vs*. Coleman, 126 N. Y. 433.

however defensible it may be on the legal ground that in the one case we are dealing with a tax on property and in the other with a tax on privilege. Except in so far as corporations may be made to pay for their charters, there is no reason why they should be put on a different footing from joint-stock companies or other associations. The ability of an association to pay—its earning power—is not changed a whit by the simple fact of incorporation. The privilege of limited liability, however important it may be to the individual stockholders and however great the amount that may be demanded for the privilege as a condition precedent to organization, does not alter the taxable capacity of the association after it has once become a corporation. If the corporate franchise, in the sense of the privilege of being a corporation, itself constituted the only justification of a tax, how would it then be possible to tax unincorporated companies in the same way? And yet to exempt the latter would clearly constitute a glaring economic inequality.

The value of the franchise from the economic point of view consists in the earning capacity of the corporation. That is the real basis of all taxation and can best be gauged by the amount of business done. It will be remembered that the court says: "Whether the tax upon a domestic corporation be called a tax upon franchise or upon business is wholly unimportant." [1] We may go farther and say that from the economic standpoint it is wholly immaterial whether the tax upon any corporation be called a tax on franchise or a tax on business. In an economic sense the franchise tax means nothing at all. It is so utterly indefinite that it defies exact analysis. However valuable it may be to the lawyer in the effort to evade certain constitutional restrictions, to the student of the science of finance it is a useless conception.

If we sum up the above discussion as to the two kinds of franchise tax which we have been studying—the franchise tax as a property tax and the franchise tax as a non-property tax—we are in a position to gauge its real value. The first kind of a franchise tax, as we now know, was devised in order to fit a concept based primarily upon earnings or income into a system of taxation based on property or capitalized income. The second kind of a franchise tax was devised, as we have seen, to overcome the still remaining difficulties of a property tax. The objection to the first kind of a franchise tax is that as a property

[1] 96 N. Y. 396.

tax it is a mere piece of guess work, leading to arbitrariness and furnishing no opportunity for effective redress on the part of the taxpayer. The objection to the second kind of a franchise tax is that it is a mere makeshift or legal subterfuge. Both kinds of franchise taxes furnish eloquent testimony to the shortcomings of a tax system where the criterion of ability to pay is still made to reside in property rather than in product or income. For all the manifold complications and litigations that attend the American franchise tax are unknown elsewhere in the world where the general test of faculty in taxation is considered to be income rather than property. The problem of the franchise tax is a part of the problem of the general property tax; if we ever shake off the incubus of the general property tax theory, as we are bound to do in the not distant future, the entire problem, and the conception itself, of the franchise will disappear from the realm of taxation.

II. *Economic Theory*

Let us therefore leave this whole subject of franchise taxation and attempt to analyze the economic principles underlying the taxes actually in vogue, irrespective of the question whether they are called franchise taxes. It will be best to take them up in the order adduced above.[1]

The general property tax, or the taxation of the corporate realty plus its visible and invisible personalty at its actual value, assessed piecemeal by the local assessors as in the case of individuals. It will not be necessary to show the inadequacy of this primitive plan; all the actual reforms are moving away from it. With the variation of this system known as the *ad valorem* tax, assessed by a state board under the unit plan, we shall deal below. But so far as the general property tax with local piecemeal assessment is concerned, we may conclude with the railroad tax commission of 1879, that as a system it is open to almost every conceivable objection.[2]

The cost of the property. As a basis for taxation this is even less defensible than the value of the property. For no one would assert that the original cost of corporate property bears any necessary relation to the present value, much less to its

[1] *Supra,* pp. 219-220.

[2] *Taxation of Railroads and Railroad Securities,* by C. F. Adams, W. B. Williams and J. H. Oberly (1880), p. 8.

present earning capacity. This method is so obviously unjust as to deserve no further mention.

The capital stock at its market value. This plan is open to several vital objections. The idea is that the market value of the stock will be practically equivalent to the value of the property, or, as it is put by some of our state courts, that the entire property of a corporation is identical with its stock. As has already been observed, heavily bonded corporations would in this way entirely escape taxation; because in such cases—and they are the great majority—the capital stock alone would not represent the value of the property. Secondly, even in the case of corporations without any bonded debt, the tax is unjust, because it does not necessarily bear any relation to the earning capacity. If a company without bonded debt pays dividends, the value of the stock is indeed a fair index to earning capacity; its value would represent the capitalized earnings. But if there are no dividends, the value of the capital stock is wholly uncertain and largely speculative, depending on the manipulations of the stock exchange. It frequently happens that non-dividend-paying stock fluctuates in value from thirty to fifty per cent within one year. A standard of taxation which in such large classes of cases bears no proportion to the earning capacity or productiveness of the property clearly cannot be successfully defended. We can again agree with the railroad tax commission in their conclusion that the tax on the value of the capital stock is "clumsy and devoid of scientific merit," that it "would admit of evasions in a most obvious way," and that "it is impossible of any general application." [1]

The New York statute which governs the taxation of corporations for local purposes requires the capital stock to be assessed "at its actual value in cash." In determining the "actual" value, the assessors may take "book value," *i.e.* a value obtained by estimating the assets separately and deducting from the aggregate the total amount of the liabilities, actual or contingent.[2] The latter method is employed when the market value of the stock is fictitious or artificially inflated, but in principle is open to precisely the same criticism as the other

[1] Report, *etc.*, p. 7. *Cf.* the *Report on the Valuation and Taxation of Railroads*, to the Pennsylvania Tax Conference, 1894, written by Mr. Joseph D. Weeks.

[2] 107 N. Y. 541.

method. In fact, the objections are rather stronger; for, whereas in the case of the tax on capital stock according to market value the bonded indebtedness is not taxed at all, in this case the bonded indebtedness is actually deducted. Under the New York law it has been decided that "capital stock" does not necessarily mean share stock, but the capital owned, the fund required to be paid in and kept intact as the basis of the business enterprise. When the capital is undisclosed, the assessor may consider the market value of the shares as an aid in discovering the capital, but not as the thing to be valued and assessed.[1] In the state franchise tax, however, whenever the law requires the "intrinsic or actual value" of the stock to be ascertained, it has been held that book value does not govern the valuation, but that the good will is also to be included.[2]

According to the Pennsylvania law of 1891 the capital stock on which the tax is assessed is to be appraised "at its actual value in cash, not less however, than the average price which said stock sold for during said year and not less than the price indicated or measure by net earnings, or by the amount of profits made and either declared in dividends or carried into surplus or sinking funds." This has led to much litigation. It has been decided, for instance, that the price at which the shares sell in the market is not conclusive;[3] and in a more general way that the actual value in cash is to be determined by "considering the value of the tangible property, the amount of its business, the rate of dividends declared, and the extent and value of its good will, franchises, and privileges, as indicated by the evidence bearing upon those subjects at that particular time.[4] The result is that in practice the taxation of capital stock, by such a method of appraisal, does not differ much from the *ad valorem* system mentioned below.

The capital stock at its par value. This method is open to all the objections of the preceding and to many more in addition. Moreover, it is peculiarly liable to evasion. For example, in New York it was a common practice, before the recent reduction of the rate to a minimum, for corporations to evade the organiza-

[1] People *vs.* Coleman, 126 N. Y. 433, distinguishing many preceding cases. See also People *vs.* Commissioners, 72 Hun, 126 (1894).

[2] People *ex rel.* J. B. Co. *vs.* Roberts, 37 App. Div. 1 (1899); and People *ex rel.* Johnson Co. *vs.* Roberts, 159 N. Y. 70 (1899).

[3] Com. *vs.* Philadelphia Co., 164 Pa. 284 (1894).

[4] Com. *vs.* John W. Haney Co., Lim., 1 Dauph. Co. Rep. 184 (1895); *cf.* Com. *vs.* Del., Susq. & S. R. R. Co., 165 Pa. 44 (1894).

tion tax by issuing a nominally small capital, but selling it to the stockholders at a premium of several hundred per cent; the market value of the stock thus being many times the par value. The sole recommendation of this plan is the facility of fixing a basis for assessment; but this does not compensate for its obvious defects. The par value of stock is no gauge of either the real worth of the property or its earning capacity.

The capital stock plus the bonded debt at the market value. The justification for adding to the value of the stock the value of what the company owes, in the shape of its funded debt, is the fact that the indebtedness makes the stock worth just so much less. The sum of the two elements is a better index to the value of the property than the capital stock alone. This method, while preferable to any that has hitherto been discussed, is yet not entirely free from objections. The proceeds of the tax will accrue not to the state of the owner's residence, but to the state where the corporate property is situated. Secondly, the market value of bonds depends not only on the rate of interest but also on the life of the security. Two companies may have raised exactly the same amount from the sale of 6% bonds, and yet at any given time the bonds of the one corporation may have a long time to run and those of the other corporation only a short time. If the normal rate of interest has fallen to let us say 4%, the market value of the bonds of the first corporation will be far higher than that of the bonds of the second corporation. Yet the discrepancy represents not any difference in the value of the respective corporate properties, but simply the difference in the amortization quota of the two classes of bonds.[1] Thirdly, when the tax is on bonds as well as on stock it will be inadequate, because applicable only to the bonds owned by residents of the state. If the tax is, however, levied not on the bonds, but on a valuation equal to the stock plus bonds, this objection may be obviated. Both these points will be discussed more fully below. Fourthly, in all those cases where the corporation pays no dividends and its stock nevertheless possesses a speculative value, the tax, for the reasons adduced above, will not necessarily bear any

[1] This inequality will in some cases be partly compensated by a change in the value of the stock. Although the bonds that mature earlier are worth less, the stocks of the "short-term" companies are apt to be worth more because of the ability of the corporation to refinance on more favorable terms.

relation to the earning capacity of the company. In short, while this method is far better than the taxation of capital stock, it does not avoid all the objections that have been urged against the latter.

There remain thus only the taxes on earnings, on business, on dividends and on profits.

The *gross earnings*. This tax was the one recommended by the railroad tax commission. It possesses many undeniable advantages. It is certain, easily ascertained and not susceptible of evasion. But it has one serious defect;—it is not proportional to the real earning capacity, it takes no account of the original cost, nor does it pay any regard to the current expenses, which may be necessary and just. For example, when the cost of building a railroad is great, its gross earnings must be correspondingly large in order to enable its owners to realize any fair return on the investment. A tax on gross earnings does not recognize this distinction. It discriminates unfairly between companies, and makes a line built at great expense and with great risk pay a penalty for the enterprise of its constructors. Again, a gross earnings tax takes no account of expenses. Of two corporations which have equally large gross receipts, one may be in a naturally disadvantageous position which unduly increases the cost of operation or management. Clearly its ability to pay is not so great as that of its rival in possession of natural advantages. Above all, the gross earnings tax makes no allowance for good management. If a corporation is managed with such ability that its business increases greatly, this will ordinarily mean a great increase in gross receipts; while, on the other hand, the net receipts or profits, although also larger, will almost surely increase not indeed in a smaller ratio, but to a smaller actual extent, than gross receipts. For with a larger business there come greater expenses. The prospect of increased net receipts is of course the stimulus to activity on the part of the owner; but if the tax is imposed on gross receipts, that stimulus will be *pro tanto* weakened. Thus a tax on gross receipts is really a tax on enterprise and foresight, and a premium on supineness or inactivity. In short, the gross receipts tax is like the old tithe, the most primitive of all land taxes.

These defects in the proportional earnings tax are so apparent that several commonwealths, as we know, have introduced, in the case of railroads at least, the graded gross earnings

tax, the rate per cent increasing with the earnings. But this system removes the objection only in part; for the graduation takes place only up to a certain point. Above all, there is no guarantee that the increase of net receipts will correspond to the increase of the gross receipts. There is no necessary connection between them. A corporation with gross receipts of five thousand dollars per mile may have actually less net receipts than one with four thousand dollars per mile. In such a case a graded earnings tax would intensify the disadvantages of the first line and augment the injustice. To tax gross earnings is, therefore, in theory at least essentially a slip-shod method. In practice, however, as we shall see, its administrative advantages are so marked as to render the gross earnings tax under certain circumstances desirable.

The business transacted. This tax, while closely analogous to the gross earnings tax, does not possess all its advantages. The business may be large but not lucrative. An extensive business does not mean even proportionally extensive gross earnings. The business transacted is an exceedingly rough way of ascertaining the prosperity of a corporation. It affords no accurate test of profits, and fails to take account of the personal equation which may make all the difference between good and bad management. Clearly, the tax on business is but a clumsy device.

The dividends or the capital stock according to dividends. Economically speaking these taxes are the same; but from the legal point of view, at least according to the opinion of the Supreme Court, there is a decided difference. The distinction is brought out in connection with the subject of extraterritoriality, and will be fully discussed below. We are here dealing only with the economic problem.

The dividends tax, it may be said, is good so far as it goes; but it does not go far enough. It is indeed true that some of the objections are slight. Thus it has been contended that this tax fails to reach the profits which are not divided but which are simply put into a reserve fund; and some commonwealths have even sought to obviate the supposed difficulty by providing that the tax should apply to the dividends, whether declared or merely earned and not divided. This objection, however, is not of great importance; for even if the undivided earnings are not taxed, they go into the reserve or surplus fund; and as this increases the corporate capital, it must in the long

run lead to increased earnings on the larger capital. Since the surplus cannot be increased indefinitely, it will ultimately find its way to the shareholders as dividends, and thus become liable to the tax.

Another objection which might be urged is that a corporation may devote a portion of its earnings to new construction or to new equipment. This expense may be defrayed out of profits, instead of from the capital or construction fund. The dividends in such a case, it might be said, do not represent the actual earning capacity of the enterprise. While this is true temporarily, the improvements made by the corporation necessarily enhance the value of the property and ultimately lead to increased dividends, so that in the long run a tax on dividends would still reach the corporation.

The real objection to the dividends tax is of quite a different character. It is inadequate when applied to those corporations which have bonded indebtedness. Thus one corporation having no bonds may earn enough to pay dividends of five per cent on its stock, while another, with the same earnings, may have devoted half to the payment of interest on bonds, and only half to the payment of dividends. A tax on dividends, while nominally just, would be actually most unjust, for one corporation would pay just twice as much as the other. The objection has been recognized in American legislation, but only once. The United States internal revenue law of 1864 provided for a five per cent tax (raised from three per cent in 1862), which, in the case of railroads, canals, turnpike, navigation and slackwater companies, was imposed on all dividends, as well as on all coupons or on all interest, on evidences of indebtedness and on all profits carried to the account of any fund. In the case of those companies which were not presumed to have any bonded debt, like banks, trust companies, savings institutions and insurance companies, the tax was imposed only on dividends and surplus. The federal law, indeed, violated strict consistency in imposing a gross earnings tax also on transportation and on certain insurance companies; but the correct implication in the law was the inadequacy of a tax on dividends alone. On the other hand, the federal law of 1909 imposing an excise tax of 1% on the "net income" of corporations is open to serious objections. For it permits among the deductions from gross income all interest actually paid in the year on bonded or other indebtedness up to an

amount of debt equal to the paid up capital. That is, since interest on the bonds is not taxable, the tax is virtually levied on dividends, or at all events on the sums available for dividends. In fine the objections to the dividends tax are closely analogous to those which we found in the capital stock tax as compared with the tax on stock plus debt. Its great defect is that it reaches only a part of the corporate earning capacity.

We thus come finally to the tax on *net earnings*, or rather on net receipts, profits or income. This is the most logical form of corporate taxation. The tax is not, like the gross earnings tax, unequal in its operation. It holds out no inducement, like the general property tax, to check improvements. It is just; it is simple; it is perfectly proportional to productive capacity. In short, it satisfies the requirements of a scientific system.

Several objections, however, might be raised to a tax on net receipts. One is that the accounts may be "cooked" by paying unduly large salaries to the officers; that is, the profits may be divided as nominal expenses, thereby leaving very insignificant net receipts or none at all. This objection, however, would not apply at all to the vast majority of corporations, whose stock or bonds are held by outside parties, that will not consent to see their dividends or interest curtailed by any practices of this nature. The danger can be real only in respect to the few corporations in which the stock is owned entirely by the managers. But these are chiefly manufacturing corporations, which, as we know, are usually exempted from the general corporation tax. Even here, however, the danger is not very great. We hear of no complaints on this score in the American commonwealths where the net receipts tax prevails; and in Europe, where this method of taxation is well-nigh universal, the objection has never been raised. It may thus be pronounced of little importance.

Secondly, it may be contended that the tax is impracticable in the case of great railroad corporations which, having leased lines in other states, are interested in so manipulating the traffic that the heavily mortgaged leased lines will earn little or nothing above fixed charges. Such cases are very common. The commonwealths in which such leased lines are situated will, it is argued, be robbed of the whole benefit of the tax; since the proceeds accrue to the state of the parent company. In reality,

this objection arises simply from a quibble about words. Of course net receipts must be strictly defined. The logical basis of corporate taxation is the total annual revenue from all sources minus all actual expenditures except interest and taxes. The reason for not deducting fixed charges, *i.e.* interest on the bonds, is the same as that which leads some of the states to levy the railroad tax on capital plus debt, and which made the federal government in 1864 tax coupons as well as dividends. Both together represent earning capacity.[1] Although the interest on the funded debt is known by the name of fixed charges, it is really part of the profits which, in the absence of funded debt, would go to the shareholders as dividends. It would obviously be suicidal so to frame the definition of net receipts as to exclude this interest on bonds. Net receipts of a corporation mean gross receipts minus actual current expenses. Any other definition would confuse the whole conception.

In several commonwealths some very dubious and arbitrary distinctions have been attempted. The Minnesota courts have held that "earnings" means only receipts from operation.[2] Under the New York law it has been held that "income" means gross income, and that "profits" means gross profits, not clear profits;[3] but this decision was owing to some peculiarities of the statutory phraseology. From the standpoint of the science of finance we understand by "income," net income, and by "profits," only net profits. So in Pennsylvania and Alabama it has been held that income, gains or net earnings means the whole product of the business, deducting nothing but expenses.[4] In Pennsylvania it has been well settled that net earnings are the excess of gross earnings over the expenditures incurred in producing them and the amount incurred in necessary repairs, but not including the amount expended in enlarging or extending the works.[5] The Thurman law, indeed, which regulated the relations of the federal government to the Pacific railroads, defined net earnings in a different way, *viz.*, as the gross earnings,

[1] *Cf. supra*, pp. 106–107.

[2] State *vs.* Railroad Co., 30 Minn. 311.

[3] People *vs.* Supervisors of Niagara, 4 Hill, 20; People *vs.* Supervisors of New York, 18 Wend. 605.

[4] Commonwealth *vs.* Pa. Gas Coal Co., 62 Pa. 241 (1869); Board of Revenue *vs.* Gas Light Co., 64 Ala. 269. In the case of mines, "net proceeds" have been defined; Montana Code, § 1791.

[5] Com. *vs.* Minersville Water Co., 13 Pa. C. C. 17 (1893); and Com. *vs.* Sharon Coal Co., 164 Pa. 284 (1894).

deducting "the necessary expenses actually paid within the year in operating the lines and keeping the same in a state of repair," and also deducting "the sums paid by them in discharge of interest on their first mortgage bonds," but "excluding all sums paid for interest on any other portion of their indebtedness."[1] The explanation of this arbitrary definition lies not in any economic principle but in a particular legislative provision whereby the first mortgage bonds were given precedence over the government liens. The Supreme Court has held that "net earnings" as here used exclude expenditures for new construction and new equipment.[2] In Virginia the taxable net income of corporations was formerly ascertained by "deducting from gross receipts the costs of operation, repairs, and interest on indebtedness." So also by the federal law of 1909 the excise tax is vitually levied only on corporate dividends; but this, as we have seen, is economically incorrect. Interest on bonds should not be exempted.

If it be desired to obtain in the case of railroad companies a more exact definition of net receipts or income, the following would be a sound method of procedure: Gross receipts consist of all earnings from transportation of freight and passengers, receipts from bonds and stocks owned, rents of property and all miscellaneous receipts from ancillary business enterprises or otherwise. From these aggregate gross receipts we should deduct what are classified by the Interstate Commerce Commission as operating expenses.[3] No deduction should be made for fixed charges, *i.e.* for taxes or for interest on the debt, or for the amount used in new construction, in betterments, in investments, in new equipment, or for any of the expenditures that find their way into profit and loss account.

The method here suggested would lead to the abolition of one of the serious abuses of American railway management—that of putting all possible expenses into the construction account. The railways, for example, formerly often failed to

[1] Act of May 7, 1878, 45th Cong., 2d Sess., chap. 96, sec. 1.

[2] Union Pacific R. R. Co. *vs.* United States, 99 U. S. 419.

[3] The operating expenses which it is permissible to deduct from the gross receipts are defined as "maintenance of way and structures" including: "repairs of roadway and renewal of rails and ties; repairs and renewal of bridges and other structures; maintenance of equipment; conducting transportation, including: salaries and wages in the operating department, supplies, car mileage, switching charges, damage for injuries, advertising, outside agencies and commissions; and general expenses."

charge the maintenance and repair of their rolling stock to current expenses. When the equipment has become unserviceable, new stock is bought and charged to the construction or to the profit and loss account. In the meantime the nominal earnings of the railway seem large, and the managers reap whatever temporary benefit they may desire. The taxation of net profits in the sense that has been indicated would tend to check this practice, since deductions would be allowed for maintenance, but not for new equipment. A tax on net receipts, thus, properly defined, would possess not only a financial, but also a wider economic advantage.

The federal corporation tax of 1909 gives a definition of net income which is clear and satisfactory, with the exception, as noted above, that it permits deductions for taxes and for interest on debt. Omitting these two points, the definition is as follows:

"Such net income shall be ascertained by deducting from the gross amount of the income received within the year from all sources: (First) All the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies, the sums other than dividends paid within the year on policy and annuity contracts and net addition, if any, required by law to be made within the year to reserve funds: [(third) and (fourth) omitted as representing taxes and interest]; (fifth) all amounts received within the year as dividends upon stock of other corporations, etc., subject to the tax herein imposed."[1]

So far as intra-state carriers are concerned, most of the state commissions now follow the system prescribed by the federal

[1] In an interesting memorandum by a number of prominent accountants attention is called to the fact that it would have been far more in consonance with modern accounting methods to substitute for the words "expenses actually paid" the words "expenses actually incurred"; and for the words "losses actually sustained" the words "losses actually ascertained". See *The Corporation Tax Law of 1909. A Letter to the Members of the American Association of Public Accountants together with Copies of Correspondence with the Attorney General.* New York, 1909.

commission. As to other public-service corporations less progress has been made, although the public-utility commissions in some important states like New York, New Jersey and Wisconsin have laid down equally minute rules applicable to these. With every year, therefore, the objections to the net earnings rule based on inability to define net earnings are losing force.

A final objection, occasionally urged, is that the net earnings tax is inadequate for the reason that corporations sometimes have no net earnings while the government always needs a revenue. This objection, however, is without much weight. For if the accounts are carefully prescribed, the absence of net earnings will be far less frequent than is commonly feared; and if it nevertheless happens that in any particular year a given corporation actually earns nothing, there is no reason why it should be called upon to pay the tax. If the rule—no net earnings taxation because of the possibility of no net earnings—were strictly followed, it would render impossible any general income tax on individuals; and yet, as we know, the tendency throughout the world is towards an income tax. The fact that individuals here and there fail to secure an income from their business or otherwise is not considered any valid objection to the imposition of an income tax in general. Corporations, like individuals, normally make profits; and where losses are incurred by some, they are more than compensated by the profits of others. The public revenue continues because of the balance of profit makers. Moreover it must not be forgotten that under a proper system of taxation, a corporation even without any net earnings would still be subject to taxation on its real estate for local purposes. But to tax a corporation for state purposes on its property when the property yields nothing, or on its gross receipts when the receipts are all swallowed up by necessary expenses, is assuredly not to be defended on any principle of equity, as a permanent rule. Above all, however, if in the exceptional case of no net earnings it is still desired to secure a revenue it is easy to adopt the simple solution of the problem, as practised in Austria.[1] The tax there is levied on net earnings, but in no case is permitted to be less than a certain percentage of the corporate capital. In this way net earnings are reserved as the normal basis of the tax, and yet some revenue is assured to the government.

[1] *Cf. infra*, p. 263.

III. *Practical Reforms*

It is clear from the above discussion that the various methods that have been reviewed, have both advantages and drawbacks. Practically, however, there are two fundamental questions: (1) Shall we choose a tax on property in preference to a tax on earnings? and (2) If the first question is answered in the negative, shall we choose a tax on gross earnings in preference to one on net earnings?

The problem involved in the first question is the advisability of the *ad valorem* system. This system, it will be remembered, differs from that of the general property tax discussed above,[1] in that the assessment of corporate property is made as a unit by a state board.

There is no doubt that the *ad valorem* system constitutes a decided advance over the primitive methods of the general property tax, not only because a valuation according to the unit rule, conducted by a state board, is at once more effective and more equal than the disjointed system, or lack of system, involved in the piecemeal assessment by local officials; but also because the *ad valorem* system now usually includes the value of the franchise, which it is well-nigh impossible to reach by local methods. So much can freely be admitted. But what shall be said of those states, like Michigan and Wisconsin, which have reverted from an earnings to an *ad valorem* system? Are we to consider this a step forward or a step backward?

The reasons for this reversion were twofold. In the first place, the earnings tax was imposed on gross earnings and some dissatisfaction was manifested with the lack of equality as between the corporations. We are told that "the principal objection was the inequalities produced in the relative amount of taxes paid by the different companies. The plan provided for a certain per cent of the gross earnings per mile and was graduated. It may have been the fault of the graduating, but the fact remains that the tax was not an equitable one and the system was abolished."[2] As a matter of fact, however, this was not the principal objection. Of far greater weight was the second reason for the change, namely, the desire for so-called equal taxation as between individuals and corporations.

[1] *Supra*, pp. 145–148.

[2] *Cf. Sixth Report of the Board of Tax Commissioners.* Lansing, 1911, p. 55.

It was claimed, and the claim was undoubtedly well founded, that the property of the public-service corporations was not taxed at the same rate as that of individuals. It was pointed out that these corporations were practical monopolies, and it was alleged that their charges were extortionate, their profits inordinate, and their owners, while enjoying special privileges, unwilling to bear their fair share of the public burdens. This cry of equal taxation won the day, and the simplest method of carrying out the mandate of the people seemed to be to make all corporate property liable equally with that of individuals.

It will at once occur to the critic to ask: if the gross earnings tax was objectionable chiefly on the ground of inadequacy, why would it not have been better simply to increase the rate of the tax and to leave all the machinery unaltered? It appeared, however, to those in charge of the movement in both Michigan and Wisconsin that an increase in the rate of the gross receipts tax would be difficult to accomplish in the face of the powerful interests engaged, and that a far more effective and more easily understood battle cry would be that of the equal taxation of all property. This argument prevailed, and it is not to be denied that it may have been the part of political wisdom in those states; although it must be borne in mind that both in Minnesota at the time and in California a few years later the other argument proved equally effective as a political shibboleth, and that the desired equality was brought about simply by the imposition of higher gross earnings taxes.

Moreover, from the point of view of tax reform in general, this demand for "equal taxation" of property must be pronounced regrettable and even mischievous. No one of course will dispute the desirability of equality in taxation; but it is necessary to define more exactly what this really implies. If a satisfactory norm of taxation, or criterion of ability to pay, is selected, equality in the application of this norm is assuredly to be desired. But, as we have seen in an earlier chapter, property in general is no longer an adequate test of ability to pay. Equal taxation, so far as property is concerned, is supposed to mean the continuation of the general property tax, undifferentiated and unclassified. This theory, which is still so widely held by the average American, is really responsible for all our troubles. As we have seen, progress is taking place here, as it took place elsewhere, through a splitting up of the general property tax, through a classification of property and through

a differentiation of taxation. Moreover, it is none the less true that equality does not necessarily mean the identical tax at the same rate on every particular piece of property. But if this is so, and if, as is now not infrequently the case, we select certain kinds of property and tax them in a different manner or at a different rate, why, it may be asked, is not the same method applicable to corporations also? The cry for "equal taxation" reflects credit on the general intuition or instinct of the partisans of the *ad valorem* system, but it does not reflect the same credit on their knowledge. For a more adequate acquaintance with fiscal theory would have brought them to the conclusion that the equal taxation of property in modern times does not necessarily mean the equal taxation of the property owner; or to put it in another way, that the equal taxation of the taxpayers—whether individuals or corporations—does not necessitate an equal taxation of their property. The test of equality under modern conditions is as we now know no longer to be found in the undifferentiated mass of property.

It is instructive to note, moreover, that in the very state where the battle for *ad valorem* taxation was won on the plea that corporate property was undertaxed, the old principle should be thrown overboard, in the face of the well-founded complaints on the part of some corporations that they are now overtaxed. We read in a recent report of the special commission in Michigan the following:

> "This complaint (of inequality) must be considered in connection with the fact that the properties to be assessed by the state board of assessors forms a class different from that assessed under the general tax law. Where it is possible to separate property into classes for purposes of taxation, it is permissible to impose varying rates upon the different classes.
>
> "It is not the purpose of this system to make a discrimination between the two classes, but if, incidentally in the process of administration, discrimination through a difference in rates arises, that fact does not even make a prima facie case against the equality of the tax levied through such a board of assessors or against the validity of the law." [1]

In other words, "equal taxation" is to be invoked when it means a remedy for the relative over-taxation of individuals;

[1] *Report of Commission of Inquiry into Taxation.* Lansing, Michigan, 1911, p. 53.

but it is not to be invoked when it means the relative over-taxation of corporations.

We may go still further and say that, entirely irrespective of the question of the basis of taxation, the attempt to put corporations and individuals on precisely the same plane in matters of taxation is based upon an essentially erroneous theory and that it fails to distinguish between the principles applicable to natural and to artificial personalities. For a corporation, after all, is a fictitious entity whose economic power consists of that of its stockholders and bondholders. The fundamental point of our whole contention is that corporations should not be treated like individuals, but should be subjected to special forms of taxation. It is gratifying to see that the truth of this contention is now being recognized by the specialists in Germany and Switzerland—the two countries where the most active discussion of these topics, outside of the United States, has taken place [1]—as well as by those of this country [2] and Canada.

[1] "Gewiss ist bei den Aktiengesellschaften eine besondere Steuerkraft vorhanden, aber dieselbe kann durch die allgemeinen Subjektsteuern von Vermögen und Erwerb nicht in geeigneter Weise in Anspruch genommen werden. Unser Wirtschaftsleben ist so kompliziert, dass die Subjektsteuern allein zur Verwirklichung der Prinzipien der allgemeinen und gerechten Besteuerung nicht ausreichen. Dazu ist ein System verschiedenartiger Steuern notwendig . . . und in einem solchen Steuersystem darf eine spezielle Aktiengesellschaftssteuer nicht fehlen. Denn auf die Aktiengesellschaften müssen, dem Wesen dieser Korporationen entsprechend, besondere Steuergrundsätze Anwendung finden."—Dr. W. Gerloff, *Die kantonale Besteuerung der Aktiengesellschaften in der Schweiz.* Bern, 1906, p. 190.

A similar conclusion is reached by the chief German writer on the subject. "Fassen wir das Ergebnis unserer kritischen Betrachtung der Besteuerung der Aktiengesellschaften durch die deutschen Personalsteuern zusammen, so müssen wir als den Grundfehler der deutschen Gesetzgebung bezeichnen, dass sie sich an die juristische Persönlichkeit der Aktiengesellschaft klammert, den wirthschaftlichen Charakter der Unternehmungsform aber in keinerlei Weise berücksichtigt. Von diesem rein formalen Ausgangspunkte aus gelangt sie dazu, die Aktiengesellschaften den physischen Personen nicht blosz in handelsrechtlicher, sondern auch in steuerlicher Beziehung *gleich zu stellen* (italics mine). Dass aber dieses über einen Kamm Scheren nicht ohne Gewaltanwendung und ohne Hintansetzung der Prinzipien der Personalsteuern möglich ist, zeigen schon die mannigfaltigen Modifikationen die an den Steuergesetzen vorgenommen werden mussten um den für physische Personen bestimmten Steuerrock auch für die Aktiengesellschaften einigermaszen passend zu machen."—L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland.* Stuttgart, 1911, pp. 132–133.

[2] *Cf.* the conclusion of Dr. G. E. Snider in his careful study, *The Taxation*

The Canadian commission which was instituted to probe this question to the bottom puts the matter so clearly as to deserve quotation in detail. After a comprehensive statement of the actual facts and after pointing out the various distinctions of fiscal importance between individuals and corporations, the commission proceeds:

"In the light of the facts here pointed out it is quite obvious that the popular belief and claim that corporate property can and should be assessed and taxed on exactly the same basis as private property is quite impossible of realization. A survey of the actual practice of taxation in different states and provinces reveals the fact that, where both corporations and private individuals are professedly taxed on the same basis of real and personal property, the greatest inequality actually prevails. Thus, if the tax is levied on tangible property . . . corporations are found to be taxed very lightly as compared with individuals. But where the so-called *ad valorem* or general property tax has been applied to corporations, in such a way that their real and personal property is valued by capitalizing the income which the corporations derive from their whole business, as in the case of the new valuations in Michigan and Wisconsin, and, in milder form, in several other states, the result has been to very considerably overtax corporations in proportion to private property. . . . To place the capitalized income of corporations upon the same basis as the general property of private individuals is plainly neither an accurate nor an equitable adjustment of taxation, as between corporate and private property.

of Gross Receipts of Railways in Wisconsin, Publications of the American Economic Association, Third Series, vol. 7, no. 4, 1906. After quoting the statement of the Wisconsin commission that "The safety of all interests rests on the principle of uniformity between all classes of property . . . there must be equality between the classes as well as between the property in the same class," Dr. Snider remarks (p. 120): "Such a program fails to recognize modern industrial conditions and patent fiscal practices. . . . The tendency and necessity have been for segregation and classification rather than aggregation and unification of property. The industrial organization is now so complex that uniformity between classes of property is an indefinite, indefinable and unattainable 'ideal.' What the Wisconsin and Michigan experience shows, what is made evident by the history of taxation in this country, is the selection of classes of property for special taxation. Real property has been the bearer in the past, corporations are having especial attention at present, and especially corporations receiving special privileges from the state. A frank recognition of the true state of affairs would do much to clear away the debris in our tax systems. . . . Had the Wisconsin commission frankly recognized this principle and said 'we believe that the railways are able to contribute more revenue to the state, and that it is desirable to levy a heavier rate upon them,' the present system, based upon a false premise, with its possibilities of political corruption, would not have been substituted for the tax on gross earnings."

"Since then it is impossible to equitably tax private property and corporate property on the same basis, there is no necessary injustice or inequality in taxing them upon different principles or by different public authorities. In fact, it is the attempt to tax them both upon the same principle which works injustice and inequality, and it is only by taxing them upon different principles suited to each form of property that it is possible to attain to approximate justice and equality."[1]

We see then that the cry of "equal taxation" is really not an adequate reason for the introduction of the *ad valorem* system. For in the first place "equal taxation of property" is in modern times not real equality of taxation; and secondly, the equality of taxation so far as it is desirable at all can be brought about as well by an earnings tax as by an *ad valorem* tax. It is entirely a question of the rate.

So much for the negative side of the argument—namely that *ad valorem* taxation is not needed in order to achieve equality. We now come to the positive side of the argument—that the earnings tax is preferable.

As we have seen above, if the basis of the corporation tax is to be put in terms of property, corporate property includes more than merely the physical property. The franchise or the immaterial elements in the property must be included. As soon, however, as an attempt is made to measure the value of the franchise, recourse must be taken, as we have learned, to earnings. It is a commonplace of modern economics that capital is nothing but capitalized income; or, to put it in terms familiar to every business man, a business or a piece of property is worth what it will earn. As the Wisconsin commission puts it:

"It is the financial rule in the markets of this country and all over the world, that the worth of property is determined by what it will produce in income. If the permanency of the income is assured from past results in operation, the risk of investment is less and the value more stable. The earnings in the opinion of financiers is the final test of the value of corporate securities, and the estimate of the earning capacity of railroads formed by such men and acted upon in buying and selling of the securities in the market generally establishes the market price."[2]

[1] *Report of Ontario Commission on Railway Taxation*, Toronto, 1905, pp. 11–12.

[2] *First Biennial Report of the Wisconsin Tax Commission*, Madison, 1903, pp. 185–186. In a later report the commission states: "As to nearly all such properties, this capacity to produce income will ordinarily be the dominant factor in ascertaining values." *Fifth Report*, 1911, p. 53. But the conclu-

Where individual pieces of property are subject to purchase and sale in the market, the property or capital value is as readily ascertainable as the earning or income value. But where, as in the case of large corporations, there is no market or no regular purchase and sale, the only possible method of ascertaining capital value (or so-called property value) is by capitalizing the earnings, present and prospective. Hence the *ad valorem* system cannot satisfy itself with the inventory method, or the mere appraisal of the physical property of a corporation. It has been found necessary to add the valuation of the franchise; and as soon as this is done, the earnings method which has been abandoned is brought in again by a back door.[1] The various boards of assessment as we have seen, generally refuse to divulge the exact method, for fear of an attack on their assessments. But that earnings is the chief factor in their appraisal is an open secret.[2] It is not a matter for pride to read in a foreign commentary:

> "We see why it is, then, that though on almost every hand, even in the states which believed themselves forced to abandon it, the earning power of corporations is held to be the only reliable and satisfactory basis of taxation . . . practically none of the American states find themselves able to frankly and fully accept it. Where it is employed, it is under some disguise or legal fiction, and commonly with the tacit consent of the taxpayer and taxing authority that the fiction shall not be called in question." [3]

sion that therefore the *ad valorem* system should be continued by no means follows.

[1] "Thus, though earning power had been expressly discarded as a basis of taxation, and the *ad valorem* system adopted in its place, yet the more the Commissioners studied the subject in its practical operation, the more they were driven back to income as the leading factor in value."—*Report of Ontario Commission on Railway Taxation*, 1905, p. 49.

[2] See the statement by one of the officials himself that in West Virginia "the element of value which is chiefly relied upon in valuing all the different classes of public service corporations is the earning power of the property." *Addresses and Proceedings of the Fourth Conference of the International Tax Association*, 1911, p. 259.

[3] *Report of Ontario Commission*, p. 17. On another page the Commission sums up its estimate of the *ad valorem* system—an estimate, in which every impartial judge will concur: "The state of Michigan in determining to change from the gross earnings to the *ad valorem* system of taxing its railroads, made the most elaborate and perfect attempt on record to determine what the physical property of the railroads was worth on the basis of cost of reproduction, less the normal depreciation for wear and use. But when at a cost of $60,000, this very elaborate and accurate appraisal

If, however, the *ad valorem* method necessarily means in practice the indirect use of the earnings method, the question arises: why not use directly what you are compelled to use indirectly. We may go further and affirm that nothing is gained, but much is lost, by electing the indirect, rather than the direct, earnings method. For, as we have seen, the direct earnings method is susceptible of reduction to a mathematical rule; whereas the indirect earnings, or *ad valorem*, method is open to the objections of secret, irresponsible, star-chamber methods. We may again agree with the Ontario commission in thinking that:

"The essential fairness of taking earnings as a basis for taxation of corporations is based on the general principle that the taxes vary with the capacity of the company to pay them, whereas taxation on the basis of general property results in all manner of inequality. The amount of tangible property required by the various corporations has, in the first place, no necessary relation to their relative earning power, and in the second place, bears no accurate relation to the earning power of the same company at different periods. The capital stock tax has something of the same defect in addition to those already mentioned, yet it has a certain amount of flexibility. Only the tax on earnings follows automatically the capacity of the corporation to pay, and while even it has inequalities, yet it is very much more equitable than any other practical system." [1]

The difference between the earnings system and the *ad valorem* system is the difference between publicity and secrecy, between certainty and arbitrariness, between simplicity and complexity,

was made, what was the practical value of it for taxation purposes? Virtually nil. The real valuation was determined on quite other grounds and mainly, as was admitted by those making the assessment, on the basis of earnings. The result was that some roads were valued considerably above the cost of reproduction, while others were valued very much below it and where the valuation was much the same as that of appraisal it was a mere coincidence. Where the valuation was above the appraisal the difference was called the intangible or franchise value, but where it was below the appraisal the difference was not named, though more or less intangible also. But, though somewhat costly for Michigan, the experiment tried there has been exceedingly valuable for the rest of the world, and therefore, by us at least, the outlay need not be regretted. The experiment has demonstrated that, however serviceable such a valuation may be in affording an independent and scientific basis for judging the cost of production of modern railroads, under the varying conditions of such a state as Michigan, it is quite futile as a means of getting at the commercial value of a railroad as a going concern, or as a basis of taxation.—*Ibid.*, p. 14.

[1] *Op. cit.*, p. 23.

between precision and guess work—in short, between modernism and mediævalism.[1]

If then the earnings tax is to be preferred to the *ad valorem* tax the question remains, shall it be gross earnings or net earnings? As a matter of principle it is conceded by all writers that net earnings approach more closely to the ideal method. "It is plain," we are told by the Ontario commission, "that the only true estimate of a railroad property is its earning power or its income. Its income, therefore, would appear to be the proper and indeed the ideal basis for taxation, if," they add, "it is found to be capable of discovery and definition without too elaborate or costly a mechanism." It is owing to the doubt expressed in the last sentence that not a few authorities prefer gross earnings. For the ascertainment of gross earnings presents none of the difficulties which are deemed to be inseparable from that of net earnings. This is the position taken by the Ontario commission of 1895, by the California commission of 1906, and by the Virginia commission of 1911.

It is necessary, however, to bear in mind two points. One is the marked progress that it is being made in the matter of corporate accounting in the United States, thus annually bringing us nearer to the time when the ascertainment of net earnings will

[1] For an instructive comparison in detail between the *ad valorem* and earnings methods see the work of Snider, mentioned *supra*, page 253. For other material and discussion on this question see the *Report of the Commission on Revenue and Taxation of the State of California*, Sacramento, 1906, chaps. iii. and iv.; *First Biennial Report of the Minnesota Tax Commission*, Saint Paul, 1908, chaps. vi. and vii.; and *Second Biennial Report* of the same, 1910, chap. xviii.; *Report of the [Special] Virginia Tax Commission*, Richmond, 1911, appendix. The Virginia report terms the *ad valorem* system "complicated, confused and uncertain"; *op. cit.*, p. 256.

For an interesting contemporary discussion of the Wisconsin agitation see L. W. Bowers and F. P. Crandon, *Argument submitted to the State Tax Commission of Wisconsin on behalf of the Chicago and Northwestern Railway Company*, Chicago, 1901; F. P. Crandon, *Railway Taxation in Wisconsin*, Chicago, 1901; J. M. Dickinson, *Railway Taxation in Wisconsin, Argument made before the Joint Committee on Assessment and Collection of Taxes at Madison*, March 5th, 1901; G. R. Peck and A. S. Dudley, *Should the present System of Railway Taxation in Wisconsin be changed? Suggestions to the Honorable Tax Commission*, Chicago [1901].

For later arguments in favor of the earnings taxation of railways see *Railway Assessment and Taxation in the Province of Ontario. Arguments presented by Messrs. Hellmuth and MacMurchy to the Ontario Commission or Railway Taxation*, Oct., 1904; *Railroad Taxation, Remarks before the Minnesota Academy of Social Science at Minneapolis*, Dec. 6, 1907, by W. W. Baldwin of Burlington, Iowa.

be subject to far less difficulty than is the case at present. The other is the fact that the California commission itself, which reported in favor of gross receipts, recommended the utilization of net earnings as a necessary means of ascertaining the proper rate of the gross earnings tax.[1] Furthermore, as we have seen, many of the states which levy either a gross receipts or a franchise tax require from the corporations returns which enable the board to compute the net earnings, and which then lead to a valuation of the property through a capitalization of the net earnings. If net earnings are thus utilized indirectly, why should they not be utilized directly? The argument in this respect as to the choice between gross and net earnings is precisely the same as the one advanced above as to the choice between property and earnings taxation.

As a matter of practical wisdom it may be conceded, however, that in not a few of the American states simplicity and convenience of administration are preferable to more ideal but more difficult methods. In such states the taxation of gross earnings may be recommended as an easy solution of the problem for the time being.[2] It must, however, not be forgotten that with the improvement of administrative methods and with a fuller appreciation of the modern principles of accounting, the time is fast approaching when the net earnings system will be applicable to all corporations in general by the states, as it is now applied without difficulty by the federal government in the United States, and by most of the leading countries abroad.

One objection still remains. It has sometimes been urged that a tax on corporate property is more just than a tax on corporate earnings, because the value of a corporate security is fixed not only by its present, but also by its prospective, productiveness. This is, however, a specious objection, since under a system of

[1] *Op. cit.*, p. 95.

[2] Mr. Allen Ripley Foote makes an ingenious suggestion designed to accomplish the results of a net earnings method through the medium of a gross earnings method. His proposition is to levy on railroads at least, a flat rate tax on gross operating revenue plus a differential on the margin between operating revenue and operating expenses. *Cf.* "Taxation of Railroads in the United States," in *Addresses and Proceedings of the Fifth Annual Conference of the National Tax Association*, Columbus, 1912, p. 193 *et seq.* *Cf.* the suggestive and practical discussion in Alfred E. Holcomb, *The Assessment of Public Service Corporations*, Richmond, 1911, reprinted from the *Proceedings of the Fifth National Tax Conference;* and the same author's, *One Assessment—One Levy. Address delivered at the Second State Tax Conference held at Buffalo,* Jan., 1912.

earnings taxation the future product will be taxed when it ultimately appears. If productiveness be accepted at all as the standard of capacity—and this is tacitly assumed in the above objection—the most logical and defensible method is the taxation of the product as it appears. But consideration for the individual producer makes it necessary, as has been pointed out above, to regard net, not gross product; and, therefore, if any one principle be accepted as the basis of the general corporation tax, it should be net profits, and not gross earnings or property.

European experience all points to taxation of net earnings as the best system. One country, indeed, still assesses corporate property in some form or other. Switzerland, as we have seen, is the only European state which has retained the mediæval system, once common to all countries. The reasons, as was pointed out, are the comparative equality of conditions and the survival of the primitive villages and agricultural communities with their placid and homogeneous economic life. It is significant, however, that many of the Swiss commonwealths, in which we notice a gradual industrial development and a consequent differentiation of property, have attempted to remedy some of the obvious defects of the general property tax by supplementing it with an income tax. Thus some cantons, like Schaffhausen, Zürich, Basel, Aargau and others, tax corporations on their capital or their reserve fund; or, if the net receipts exceed a certain percentage of the capital, on their income.[1] This system resembles, although in a very slight degree, those of New York and Pennsylvania. Other cantons, like Bern, have abandoned the general property tax, and assess corporations only on their real estate and their income. Finally, some cantons, like St. Gall and Neuchâtel, tax corporations directly only on their income. Even in Switzerland, with its fondness for mediæval customs, we see, therefore, that the tendency is almost everywhere away from the taxation of corporate property. In the other European states this tendency has passed into accomplished fact.

In England, all corporations are held to be "persons" within schedule D of the income tax, and consequently they pay a tax on their net annual profits or gains. A series of important

[1] The facts stated in this paragraph are accurate as of 1895, the date of the first edition of this book. For the few changes that have taken place since that date see the details in W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz*, Bern, 1906.

cases has elaborated the principles that should determine the exact nature of net profits.[1] The rules laid down are analogous to those described in the definition of net receipts just given. The tax, moreover, is paid before the dividends are declared. Railroads are also subject to the special passenger duty of five per cent on receipts from passengers, which is merely a survival of the old tax on stage coaches, and to a corporation duty, which is intended to take the place of the "death duties" on individuals. Even in the matter of local taxation or rates the railways are taxed on what amounts roughly to net receipts. In theory the real estate of railways like that of individuals is rated on the basis of rental value, *i.e.* in the case of railways the property is locally taxable on the basis of what a hypothetical tenant would give for it if renting it. In practice the gross receipts are taken and certain rough deductions permitted. The difficulty arises from the fact that each local stretch of line or piece of real estate is separately assessed by the local officials, as is still the case in New York state. In Scotland on the other hand the unit rule is observed under the name of *cumulo-value* rating—*i. e.* a valuation of the line as a whole. From the gross receipts 73% are deducted for working expenses and tenants' allowances, separated under distinct heads. The remainder—roughly the net earnings—is divided between stations and running line, and the rates due on the latter item are then distributed or "allocated" to the separate local divisions on the basis of relative mileage. In Ireland where the unit rule is also observed, the distribution to the localities is made on the basis of train mileage.[2]

In France, all corporations pay a tax on net profits in the shape of a three per cent tax (considerably increased during the war) on dividends, coupons and profits, known as the tax "*sur le revenu des valeurs mobilières.*" The tax is also applicable to joint-stock companies and to commercial enterprises,[3] while mutual insurance companies and similar associations have by

[1] Ellis, *A Guide to the Income Tax Acts*, 2d edition, pp. 80, 92–101.

[2] For details of the system in the three countries see the *Final Report of the Royal Commission on Local Taxation*, 1901.

[3] The tax is imposed on "les intérêts, dividendes, revenus et tous autres produits des actions de toute nature" of stock companies, and on "les intérêts, produits et bénéfices annuelles des parts d'intérêt et commandities" of all associations, *etc.*, without a divisible share capital. Law of June 29, 1872, art. 1. *Cf.* Tanquerey, *Traité théorique et pratique de l'impôt sur le revenu des valeurs mobilières*, pp. 23, 51, 143, *etc.*

judicial interpretation been exempted. Like individuals, corporations are also subject to real estate taxes and to the license taxes (*impôts des patentes*) on occupations. In the case of railroads, however, we still find a partial tax on gross receipts. The five per cent tax on gross receipts from freight, which was imposed after the Franco-Prussian war, proved to be so vexatious and so obstructive to industrial development that it was abolished a few years later.[1] But the old "tax on public conveyances"—a percentage on the fare—, which dates from the last century, was extended in 1855 to the receipts from passengers and from express traffic. In practice, this "public conveyance" or transportation tax[2] is not a direct tax on the corporations, but an indirect tax on passengers and on consignors of express packages; for the tax is added to the price of the ticket or receipt and is paid by the individual. The only direct tax is thus laid on net earnings. Corporations also pay the indirect taxes, like the stamp tax (*droit de timbre*) and the transfer tax (*droit de transmission*) on shares and bonds; but, simply to facilitate the administrative procedure, they may and generally do commute for these by paying an annual tax of one-twentieth and one-fifth of one per cent respectively on the amount of their capital stock.

In Italy corporations are taxed on their income or net earnings by the *imposta sui redditi della ricchezza mobile.* This "revenue of personal property," as it is called, is declared to consist, so far as corporations are concerned, in "all interest or dividends paid." [3] To make the term *dividends* still clearer, the law provides that "in the estimate of income are included all sums, under whatsoever title, distributed among the shareholders or added to capital, surplus or sinking fund or otherwise used in cancelling debts." [4] The Italian system is thus as comprehensive as the English.

[1] Levied in 1874; abolished in 1878.

[2] Droit sur les voitures publiques. *Cf.* Vignes, *Traité des impôts en France,* 4th edition, i., p. 192.

[3] "Sono considerati come redditi di ricchezza mobile esistenti nello stato . . . gli interessi e dividendi pagati . . . delle compagnie commerciali, industriali e di assicurazione." Law of August 24, 1877, art. 3, b.

[4] "Nel reddito delle società anonime ed in accomandita per azioni, compresevi le società d'assicurazione mutua od a premio fisso saranno computate indistintamente tutte le somme ripartite sotto qualsiasi titolo fra i soci e quelle portate in aumento del capitale o del fondo di riserva ed ammortizzazione, od altrimente impiegate anche in estinzione dei debiti." *Ibid.,* art. 30. *Cf.* in general, Oronzo Quarta, *L'imposta sulla Ricchezza Mobile,* 2 vols. (Turin). See also Alessio, *Saggio sul Sistema Tributario in*

In Germany the taxation of corporations before the Great War varied widely.[1] A few of the smaller states taxed corporations for state purposes only on their realty and on their occupation (*Gewerbe-steuer*), and not on their income or net profits, because the shareholders were individually taxed on their income from the corporations. This point will be discussed in detail in the following chapter. In most of the states, however, corporations were taxed on their income. In a few cases, indeed, they were also subject to the supplementary and very slight property taxes recently imposed. The local taxes vary exceedingly throughout the empire. But whenever corporations are taxed at all on receipts, it is on net income. Corporations were formerly exempt from the local income tax, but they are now usually subject to it wherever it exists.[2] In only one instance are corporations taxed on their capital stock—in the case of mutual insurance companies, whose so-called dividends merely return in part the premiums paid by policy holders. On account of the difficulty of ascertaining the exact profits, Baden therefore levied the income tax on an assumed amount of net profits, fixed at five per cent of the capital stock.[3] Germany was still backward in its system of corporate taxation, in that it did not yet recognize the necessity of special corporation taxes and still clung in great measure to the principle of "equal taxation" with individuals, which the scientists concede to be a mistake.[4] Since the war, however, all corporations are subject to the federal tax on income, a part of which is then redistributed to the states.

In Austria all corporations have for some years been subject to a special tax of ten per cent on net profits (including interest

Italia, i., p. 345; and the various authorities mentioned in Seligman, *The Income Tax*, 1910, p. 339.

[1] For full details as to corporate taxation in each of the German states in 1888 see Antoni, "Die Steuersubjecte in Zusammenhalte mit der Durchführung der Allgemeinheit der Besteuerung nach den in Deutschland geltenden Staatssteuergesetzen," in *Finanz-Archiv*, v. (1888), pp. 382–499, especially 475 *et seq.* For the later details see L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland.* Stuttgart, 1911.

[2] *Cf.* Meier, "Ueber die Frage der Communalbesteuerung" (in *Zehn Gutachten und Berichte über die Communalsteuerfrage, veröffentlicht vom Verein für Socialpolitik,*) p. 104.

[3] Lewald, "Die direkten Steuern in Baden," in *Finanz-Archiv*, iii., p. 807.

[4] See the explanation of the "Rückständigkeit" of the German states in Blum, *op. cit.* p. 139.

on bonds), but with two interesting variations: first that if dividends exceed 10%, the rate is higher; and second, that if there are no profits at all the tax must be at least one per mill of the stock and bonds.[1] The net receipts tax may thus be declared applicable in theory to all corporations. Some peculiar limitations arise, it is true, from the clashing of commonwealth laws, but these will be discussed in the next chapter.

IV. *The Legal Situation*

Our conclusion that the taxation of receipts is without doubt the best system brings us face to face with the facts of American constitutional law. Is a tax on receipts unconstitutional? Is it in conflict with the constitutional inhibition of state interference with interstate commerce? This is an important question. Let us, then, consider the legal as well as the economic aspects of the problem.[2]

The earliest important case involving this question construed the Pennsylvania law which imposed a tax on each ton of merchandise carried, and an additional tax of a certain percentage on the gross receipts of railroad companies. The tonnage tax was declared unconstitutional.[3] The same principle was later applied to a tax of one cent for every message sent by a telegraph company. This also, was held to be void as a tax on interstate commerce.[4] On the other hand, a state tax on the gross receipts of a domestic railroad company was upheld chiefly on the ground that the tax was laid upon a fund which had already become property. The gross receipts were said to be the fruits of transportation after they had become intermingled with the other property of the carriers.[5] The court, however, also contended that

[1] Steinitzer, *Die jüngsten Reformen der veranlagten Steuern in Oesterreich*, Leipzig, 1905; and the same author's "Zür Besteuerung der Aktiengesellschaften in Oesterreich," in Conrad's *Jahrbücher*, dritte Folge, vol. xxviii. (1904), p. 319 *et seq*.

[2] See in general, Goodnow's "Taxation of Railway Gross Receipts," in *Political Science Quarterly*, vol. ix. (1894), p. 233, and "State Taxation of Interstate Commerce," in *Publications of the American Economic Association*, vol. v. (1904), p. 153 *et seq*. *Cf*. T. R. Powell, *Indirect Encroachments on Federal Authority by the Taxing Power of the States*, a volume reprinted in 1919 from articles in the *Harvard Law Review*, vols. xxxi., xxxii.

[3] State Freight Tax Cases, 15 Wall. 232 (1872).

[4] Telegraph Co. *vs*. Texas, 105 U. S. 460 (1881).

[5] State Tax on Railway Gross Receipts, 15 Wall. 284 (1872). This was in imitation of the case of Brown *vs*. Maryland, which held that articles lost

this was a tax on the franchise, measured by the amount of the business transacted, so that it was not clearly decided what was taxed, the franchise or the property.[1] Later the Supreme Court limited this general principle and decided that when the gross receipts, even of a domestic corporation were derived entirely from interstate or foreign commerce, they could not be taxed.[2]

In the case of foreign companies, the rule seemed at one time to be more strict; for a tax on the gross receipts of a foreign corporation, even if derived only in part from interstate commerce, was declared void to the extent that the receipts were derived from such interstate commerce.[3] A tax on the gross receipts from business done wholly within the state was, however, upheld.[4]

This distinction between foreign and domestic companies seemed to be maintained in a later leading case. The Maine tax on gross receipts was upheld as being a tax not on receipts, but on the privilege of exercising the corporate franchise, the resort to receipts being made simply to ascertain the value of the business. But although this action was brought nominally against a foreign corporation, the facts show that the tax was due from a domestic corporation leased by this foreign corporation.[5]

The reason for the distinction between domestic and foreign corporations, if there was such a distinction, in the view of the court, seems to be that in the case of a domestic corporation the

their character of imports after they had left the original package or the hands of the original importer, and had then become a part of the general property of the state. But see the second note following. See also Baltimore and Ohio R. R. Co. *vs.* Maryland, 21 Wall. 456 (1874), which held that a charter stipulation that a railway should pay a part of its earnings to the state as a bonus, was not a tax, and was perfectly valid.

[1] In Fargo *vs.* Michigan, 121 U. S. 210, the court emphasizes this side of the Railway Gross Receipts Tax decision. For a recent case, see People *ex rel.* R. R. Co. *vs.* Campbell, 74 Hun, 210.

[2] Philadelphia S. S. Co. *vs.* Pennsylvania, 122 U. S. 326 (1886). In this case the court showed that the case of Brown *vs.* Maryland was really no authority for the decision in the case of the State Tax on Railway Gross Receipts, decided fifteen years before.

[3] Fargo *vs.* Michigan, 121 U. S. 230 (1886); Western Union Telegraph Co. *vs.* Alabama Board of Assessment, 132 U. S. 472 (1889). *Cf.* Coe *vs.* Errol, 116 U. S. 517 (1885).

[4] Ratterman *vs.* Western Union Telegraph Co., 127 U. S. 411 (1888).

[5] Maine *vs.* Grand Trunk R. R. Co., 142 U. S. 217 (1891). The real party to the case was the Atlantic and St. Lawrence R. R. Co.

thing taxed is the franchise, which may be measured at the discretion of the legislature (except that when all receipts are from interstate commerce the tax is invalid); while in the case of a foreign corporation the franchise cannot be taxed, but only the business. Since the thing taxed in the latter case is the business, the constitutional provision is violated whenever that business is so extended as to include interstate commerce.[1]

The same distinction which is observable in the Gross Receipts Tax cases has been maintained in others. Thus a license tax on foreign companies doing an interstate business is held invalid because it is a tax on the privilege of doing interstate commerce;[2] but a license on a domestic corporation for boats used in interstate commerce is valid.[3] So, too, a privilege tax upon every sleeping car belonging to a foreign corporation has been declared unconstitutional as a regulation of interstate commerce;[4] but when the sleeping cars are run wholly within the state over the line of a domestic corporation, the tax is valid.[5] Again, a tax proportioned to capital stock and dividends is valid as to domestic corporations even though they be engaged in interstate commerce;[6] but if the business of a foreign corporation is interstate commerce exclusively, the tax on capital stock is void.[7] On the other hand, even though the tax be imposed on a

[1] *Cf.* Horn Silver Mining Co. *vs.* New York, 143 U. S. 305.

[2] United States Express Co. *vs.* Allen, 39 Fed. Rep. 712; Leloup *vs.* Port of Mobile, 127 U. S. 640; Krutcher *vs.* Kentucky, 141 U. S. 47.

[3] Wiggins Ferry Co. *vs.* East St. Louis, 107 U. S. 365 (1882). *Cf.* Osborn *vs.* Mobile, 16 Wall. 479 (1872), where a license fee was imposed on an agent of an express company doing business in Mobile.

[4] Pickard *vs.* Pullman Southern Car Co., 117 U. S. 34 (1886). It was distinctly held that the cars in question had no *situs* in the state (Tennessee) imposing the tax.

[5] Gibson County *vs.* Pullman Southern Car Co., 42 Fed. Rep. 512 (1890). Whether the counties may levy such a tax depends entirely upon the authorization which must be express, given them by the state law.

[6] People *vs.* Wemple, 117 N. Y. 136 (1889).

[7] People *ex rel.* Pennsylvania R. R. Co. *vs.* Wemple, 138 N. Y. (1893). This was the case of a railroad corporation whose line terminated without the state, but which had terminal facilities within the state for the delivery of passengers and freight, the sale of tickets and the collection of dues. A somewhat similar case was that of Gloucester Ferry Co. *vs.* Pennsylvania, 114 U. S. 196 (1885). Here the state attempted to impose a tax on the capital stock of a New Jersey company having no property in Pennsylvania except a wharf in Philadelphia. This tax was held void, as an interference with interstate commerce. Another similar case was that of Norfolk and Western R. R. Co. *vs.* Pennsylvania, 136 U. S. 114 (1890). The railway had no line in the state, but had an office there, and traffic contracts which

foreign corporation, if it is assessed not on the business itself, but on the capital stock or property according to mileage, and if the corporate property is actually situate in the state, it will be upheld.[1]

The law, therefore, seemed to distinguish in part between foreign and domestic companies. Yet in the Maine case, the tendency of the court, although it was expressed only in a dictum, seemed to be opposed to this distinction; and the reasoning of the court would tend to uphold a gross receipts tax, whether imposed on domestic or on foreign corporations, provided any of the receipts be earned within the state.[2] This legal reasoning was also economically sound, for from the economic point of view the distinction between domestic and foreign corporations is entirely indefensible. Strictly carried out, it would render substantial justice in taxation almost impossible. If a foreign corporation cannot be taxed where its earnings are received, because it is a foreign corporation; and if it cannot be taxed by the state of its domicile, because the earnings are not received there, it would manifestly evade its due share of the burden. But if every state could tax the receipts of any corporation, so far as they are actually earned within the state, no corporation could escape under the plea of its foreign origin, and the foundations would be laid for an equitable system based on interstate agreement. The force of the constitutional provision would, moreover, still be sufficiently strong to prevent

made it a part of a system doing interstate business. A tax on capital stock of this corporation was held invalid, as interfering with interstate commerce.

[1] Pullman Car Co. *vs.* Pennsylvania, 141 U. S. 18 (1890); Pullman Palace Car Co. *vs.* Assessors, 55 Fed. Rep. 206 (1893). *Cf.* Telegraph Co. *vs.* Massachusetts, 125 U. S. 530 (1890).

[2] "The privilege of exercising the franchises of a corporation within a state is generally one of value, and often of great value and the subject of earnest contention. It is natural, therefore, that the corporation should be made to pay some proportion of the burdens of the government. As the granting of the privilege rests entirely in the discretion of the state, *whether the corporation be of domestic or foreign origin*, it may be conferred upon such conditions, pecuniary or otherwise, as the state in its judgment may deem most conducive to its interests or policy. . . . The character of the tax or its validity is not determined by the mode adopted in fixing its amount for any specific period or the times of its payment. . . . The rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results both to the state and the corporation taxed." Justice Field, in Maine *vs.* Grand Trunk R. R. Co., 142 U. S. 217 (1891).

unjust discriminations against foreign commerce or foreign business.

More recent cases have now definitely settled both the untenability of the distinction between foreign and domestic corporations in this matter and the precise extent to which gross receipts taxation is constitutionally permissible. In the Wisconsin case a tax was sustained which made the income of a railroad company within the state, although including interstate earnings, the measure of the value of the property. The court said:

"In form the tax is a tax on 'the property and business of such railroad corporations operated within the state,' computed upon certain percentages of gross income. The *prima facie* measure of the plaintiff's gross income is substantially that which was approved in Maine *vs.* Grand Trunk Railway Co."[1]

Shortly afterwards, in the Texas case, a tax of 1% on the gross receipts of a *domestic* company was declared invalid on the ground that the tax was imposed on the receipts as such. Justice Holmes attempted to distinguish this case from the Maine case on the ground of a difference between a tax on property and a tax on commerce.[2]

"'By whatever name the exaction may be called, if it amounts to no more than the ordinary tax upon property or a just equivalent therefor, ascertained by reference thereto, it is not open to attack as inconsistent with the Constitution.' *Telegraph Cable Co.* v. *Adams*, 155 U. S. 688, 697. See *New York, Lake Erie & Western R. R. Co.* v. *Pennsylvania*, 158 U. S. 431, 438, 439. The question is whether this is such a tax. It appears sufficiently, perhaps from what has been said, that we are to look for a practical rather than a logical or philosophical distinction. The State must be allowed to tax the property and to tax it at its actual value as a going concern. On the other hand, the State cannot tax the interstate business. The two necessities hardly admit of an absolute logical reconciliation. Yet the distinction is not without sense. When a legislature is trying simply to value property, it is less likely to attempt to or effect injurious regulation than when it is aiming directly at the receipts from interstate commerce. A practical line can be drawn by taking the whole scheme of taxation into account. That must be done by this court as best it can."

[1] Wisconsin & Michigan Railway Co. *vs.* Powers, 191 U. S. 379.

[2] Galveston, Harrisburgh & San Antonio Ry. Co. *vs.* Texas, 210 U. S. 217.

In the meantime, this distinction between a tax on property and a tax on commerce was strengthened by a number of cases which upheld the legitimacy of a tax on property, even if some of the property was used in interstate commerce.[1]

Finally, however, in 1912 the whole controversy was laid to rest, in principle at least, by two cases decided on the same day. In the Oklahoma case,[2] a gross receipts tax of 3%, levied in addition to the general property tax, was declared invalid because clearly a tax on the gross receipts as such, and therefore on the receipts from interstate commerce. On the other hand, in the Minnesota case,[3] a tax of 6% on the gross receipts was upheld because declared to be in lieu of all taxes on the property of the corporation.

Under this decision the constitutionality of a gross earnings tax is henceforth indisputable, provided only that the earnings

[1] The case of Western Union Telegraph Co. *vs.* Mass., 125 U. S. 530 (1887), which upheld a tax on that proportion of the capital stock of a corporation that the state mileage bore to the entire mileage, was applied to a railroad in C. C., C. & St. Louis Ry. Co. *vs.* Backus, 154 U. S. 439 (1894); and to an express company in the Express Cases, 165 U. S. 195 (1897). These cases upheld the legality of the so-called unit rule. Again while a license tax on each Pullman car was declared invalid as an interference with the privilege of engaging in interstate commerce in Pickard *vs.* Pullman Southern Car Co., 117 U. S. 34, a tax on the capital stock of a similar company in proportion to the mileage of the cars run in the state as compared to the total mileage was upheld in P. C. C. Co. *vs.* Pa., 141 U. S. 18; and a tax levied by Tennessee upon "each sleeping car doing business within the state" for purely intra-state business was upheld on the ground that there was no compulsion to do this business. Allen *vs.* Pullman Co., 191 U. S. 171 (1903). On other hand, the Kansas tax of 1/10 of 1% on the authorized capital stock of a similar company was declared inadmissible as a burden on interstate commerce. Pullman Co. *vs.* Kansas, 216 U. S. 56 (1910). *Cf.* Western Union Tel. Co. *vs.* Kansas, 216 U. S. 1 (1910). Later cases seek to make distinctions based on the actual fact whether the tax is a real burden on interstate commerce. In Lusk *vs.* Botkin, 240 U. S. 236 (1916) and Kansas City, M. and B. R. Co. *vs.* Stiles, 242 U. S. 111 (1916), Kansas taxes on a foreign railroad company were sustained, and in St. Louis S. W. Ry. Co. *vs.* Arkansas, 235 U. S. 350 (1914) a similar Arkansas law was upheld. On the other hand in Looney *vs.* Crane Co., 245 U. S. 178 (1917), the Western Union case of 1910 was followed. For an elaborate discussion of the late cases, which does not, however, succeed in presenting a very clear picture of the principles underlying the Supreme Court decisions, see T. R. Powell, *Indirect Encroachment on Federal Authority by the Taxing Powers of the States*, referred to *supra*, p. 264.

[2] Meyer, Auditor, *vs.* Wells, Fargo & Co., 223 U. S. 298.

[3] U. S. Express Co. *vs.* Minnesota, 223 U. S. 335.

tax takes the place of the property tax and is not levied as an addendum to it.[1] We may indeed criticize from an economic point of view a decision which declares a tax on earnings to be a tax on property or equivalent to it. But we must none the less applaud the ingenious way in which the Supreme Court has extricated itself from a difficult position. It must be remembered that the Supreme Court was dealing with a situation where the ordinary tax—on individuals and corporations alike—was the general property tax; and the problem presented was, if possible, to uphold a state earnings tax in terms of a property tax "or its equivalent." This problem the court has successfully solved, and the way is thus open for the development of a proper system of corporate taxation untrammelled, in one important respect at least, by the fancied limitations of a federal constitution. And when a little later the question of the constitutionality of a state tax on corporate incomes or net earnings arose, the court had no difficulty in upholding such a tax as in no way contravening the commerce clause of the constitution.[2]

A tax on corporate earnings, according to a law properly drawn, is therefore not only economically correct but legally unassailable.

The only question that still remains is whether, under these decisions a local tax on the real property of corporations will be permissible contemporaneously with a state tax on earnings. It is to be hoped—and, may we add, to be expected—that when this question is presented the court will take the view that a local tax on real estate is in no way to be confounded, or to be regarded as inconsistent, with a state tax on earnings. When once this question is decided correctly, the progress of corporate tax reform will be assured.

This, therefore, is our general conclusion; but it does not yet exhaust the problem of corporate taxation. We are, in fact, only on the fringe of the difficulties. Let us proceed in the next chapter to study some of the more complicated questions.

[1] Later decisions along the same general lines are U. S. Express Co. *vs.* Minn., 246 U. S. 450 (1918) and Cudahy Packing Co. *vs.* Minn., 246 U. S. 456 (1918). *Cf.* also Ohio Tax Cases, 232 U. S. 576 (1914), which upheld a state tax on gross receipts from intra-state business, even though the tax was not in lieu of a property tax.

[2] U. S. Glue Co. *vs.* Oak Creek, 247 U. S. 321 (1918), affirming the constitutionality of the Wisconsin income tax law.

CHAPTER VIII

THE TAXATION OF CORPORATIONS

III

COMPLICATIONS AND CONCLUSIONS

The discussion of the taxation of corporations would be incomplete without an examination of the various phases of double taxation. This is the more necessary for the reason that no attempt at a thorough analysis has ever yet been made. Yet the problems that hinge upon this particular question are so especially important in the United States as to demand the most serious attention.

In a former chapter[1] we have already discussed some of the general aspects of double taxation. Let us now attempt to develop the principles in the light of actual practice.

There are in reality no less than five different forms of double taxation in the case of corporations:—

1. Double taxation of property and of debts, or of income and of interest on debts.
2. Double taxation of property and of income.
3. Double taxation of property and of stock.
4. Double taxation arising from conflicts of jurisdiction.
5. Double taxation of the corporation and of the holders of stock or bonds.

I. *Taxation of Property and of Debts*

This first case need not detain us long. The only illustrations in the United States are found under the general property tax, which we have discarded as the basis of corporation taxation. In many of the states corporate debts must be considered in estimating the value of the capital stock. In New York, as regards local taxation, the indebtedness must be taken into

[1] *Supra*, chap. iv.

account in assessing the capital stock; but after the valuation has been fixed, the amount of the indebtedness cannot be deducted.[1] If the capital stock is of no value because the indebtedness exceeds the assets, it should not be assessed.[2] In the case of foreign corporations, however, which are taxable on the amounts invested in the state, it has been held that the law does not contemplate the deduction of debts.[3]

We have already pointed out that there is really no injustice in not exempting corporate indebtedness.[4] The mortgage bonds of a corporation are really a part of the working capital. Correct policy demands the taxation of corporate bonds as well as of stock, of loans as well as of share capital. To tax corporate debts may, indeed, be called double taxation in so far as the tax on both stock and debt is paid out of the same income; but if so, it is double taxation of a perfectly legitimate kind. It is here that the principles of individual and corporate taxation diverge.

Some of the American commonwealths, as California, Connecticut, Maryland and Pennsylvania, recognize this distinction between the taxation of individuals and that of corporations, by permitting the deduction of indebtedness from the property of individuals but refusing a like deduction in the case of corporate property. In California, the courts held distinctly that what would be double taxation in the case of individuals is permissible in the case of corporations.[5] Some of the Swiss cantons, like St. Gall, Zürich and Ticino, observe the same distinction.[6]

Perhaps more interesting and probably of greater future importance in the United States is the other phase of this question of the taxation of indebtedness—double taxation of income and of interest on debt. While the true theory of income taxation in the case of individuals demands the deduction of interest on debts, it has already been shown that in the case of corporations the interest paid on mortgage bonds must be included in the taxable income. Taxation of interest on corporate debt is not double taxation, because the coupons, like the dividends,

[1] 1 Thomp. and C. 635; 100 N. Y. 597; 112 N. Y. 565.
[2] People *vs.* Commissioners, 31 Hun, 32 (1st Department).
[3] People *vs.* Barker, 141 N. Y. 118.
[4] *Cf. supra*, p. 106.
[5] Central Pacific R. R. Co. *vs.* Board of Equalization, 60 Cal. 35.
[6] Schanz, *Die Steuern der Schweiz*, ii., p. 338; ii., p. 435; iv., p. 281.

are integral parts of the income; because both bonds and stock together form what is really the working capital from which the income is derived. This question has already been discussed; but the difference in economic significance between most corporate bonds and ordinary individual debts must be continually borne in mind.

II. *Taxation of Income and of Property*

This second form of double taxation, like the first, involves no very complicated question; nor does the solution present many difficulties. Is it permissible to tax a corporation both on its property and on its net receipts or income? If corporations are put upon the same plane as individuals, the simultaneous taxation of the property and of the income from the property works no injustice. As we have seen above,[1] if all are treated alike and if the tax is uniform, there is really no cause for complaint.

So far as corporations are concerned, this was until recently not a matter of practical importance. The only case in which this special question formerly arose was under the laws of Alabama, now repealed, which provided for the taxation not only of corporate property but also of the corporate income during the preceding year.[2] Such taxation was upheld on the ground that it was only apparently double taxation.[3] What the court meant was, of course, not that it was not double taxation, but that it was not invalid or economically unsound taxation. In this the court was correct, for the law applied equally to all individuals and to corporations. Now, however, under the new (1911) income tax of Wisconsin which is deemed to take the place of the tax on intangible personalty, henceforth exempted, corporations are still taxable on their real estate and tangible personalty as well as on their income, but they are permitted to deduct from their taxable income all sums paid for taxes in any part of the country upon the source from which the income is derived. Moreover, all public-service corporations (as well as insurance companies) which pay taxes directly to the state are exempt from income tax altogether.

[1] *Supra*, p. 100.

[2] Ala. laws of Feb. 22, 1866; Feb. 19, 1867; Dec. 31, 1868; March 19, 1876; March 6, 1876.

[3] Board of Review *vs.* Montgomery Gas Light Co., 64 Ala. 276. *Cf.* Lott *vs.* Hubbard, 44 Ala. 593.

At present in the United States apart from the situation in Wisconsin, no attempt is made to tax simultaneously both corporate property and corporate income. The nearest approach to the practice is the system in some states like Maryland, Pennsylvania and New York of taxing the capital stock and also the gross receipts of certain corporations. No objection has been raised to these taxes on the score of double taxation; nor is it likely that such an objection will be sustained.[1] One might as well object to a combination of direct and indirect taxes as involving duplicate taxation, on the ground that all taxes are in the last resort paid (or presumed to be paid) out of annual income. So again, in some of the Southern and Western states, as we know, corporations are taxed on their business, by license or occupation taxes, and again on their receipts, and this practice is upheld as perfectly valid.[2] This second form of double taxation is entirely proper.

The classic home of double taxation of this sort is Switzerland. Baselstadt, for instance, taxes corporations one per mill on the paid up capital, a quarter of one per mill on the capital not yet paid up, and one per cent on the total net income from all sources.[3] In Baselland corporations are taxed on their general property and again on their total profits, with the exception that when any of the profits consist of interest on capital the profits are not taxed if the capital has already been assessed.[4] Many of the cantons, however, seek to avoid the simultaneous taxation of property and income by an arrangement of the following sort: While the law provides for the assessment of both property and income, a deduction is made in the case of the income tax for so much of the income as is supposed to represent the actual profits of the capital already taxed. The proportion thus deducted is fixed in accordance with the estimated current rate of interest, ranging from four per cent in Thurgau and Grisons to five per cent in Zug, Schaffhausen, Ticino, Vaud and Zürich. The federal government deducts five

[1] In U. S. Electric Power and Light Co. *vs.* State, 79 Md. 63, a vigorous objection has now been made, but the objection was not sustained by the court.

[2] *Cf.* 95 Mo. 360, where the court holds that it is not duplicate taxation.

[3] Law of 1889, §§ 2, 3. Schanz, *Die Steuern der Schweiz*, ii., p. 84; v., p. 50. As to the Swiss conditions mentioned in this paragraph, *cf.* the warning, *supra*, p. 260, note.

[4] Schanz, *op. cit.*, i., p. 55; v., p. 35.

per cent.[1] This principle has now also been applied in Germany. In Prussia, since 1891 the income tax is assessed on corporate income, after deducting a sum equal to three and a half per cent of the paid up capital.[2] In Baden and Würtemberg the deduction is limited to 3% and cannot exceed the amount of dividends declared.[3] Bern and St. Gallen are the only Swiss cantons which attempt to draw a sharper line by levying the property tax solely on the corporate real estate, but subjecting all the other property to an income tax.[4] In St. Gallen the real estate tax is for local, the income tax for cantonal purposes.

The solution of the supposed difficulty attempted by the Swiss and the German commonwealths is, however, not a happy one. The deduction from income of the three or five per cent, assumed to represent the earnings of property involves a misconception. It is impossible to say how much of the income represents earnings of capital and how much represents the other ingredients of profit. We are brought face to face with complicated questions of economic theory—with the distinction between interest and profits, and the separate ingredients of profits. A discussion of these questions lies beyond the province of this essay. But it may be confidently asserted that if a railway corporation with no bonded indebtedness and a capital of one million dollars earns seventy-five thousand dollars, it is impossible to maintain that fifty thousand dollars represents the earnings of the property and the remainder the earnings of the management. From one point of view all such profits are profits on capital or property. An individual can indeed obtain a professional income without any capital; but in the case of a business with capital invested, it is impossible to say how much of the profits are due to the capital, how much to the personal management. Without the capital there would be no profits at all, because there would be no business. Therefore, in taxing profits we are really taxing property, or rather the proceeds of property. To segregate a part of these proceeds and to say, as do the Swiss cantons, that only this particular part represents the income from the property, is an entirely arbitrary proceeding.

[1] Schanz, *op. cit.*, i., p. 56.

[2] *Einkommensteuergesetz* vom 24 Juni, 1891, § 16.

[3] L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland*, Stuttgart, 1911, pp. 48, 52.

[4] Schanz, *op. cit.*, ii., pp. 318, 368; iii., p. 292.

Again, it cannot be contended that even this four or five per cent of income exempted by the Swiss laws represents only the interest on the capital, and that the remainder of the income represents the earnings of management. Under no theory of economic profits can the surplus above current interest be entirely dissociated from capital. Even granting that a sharp line can be drawn between interest, earnings of management and profits, it still remains incorrect to confine the proceeds of capital to interest alone. It is thus inadmissible to say that in taxing income only on the surplus above four or five per cent of the taxable capital we avoid taxing both property and income.

The Swiss system has indeed a very decided significance in connection with an entirely different matter, *viz.*, the question of funded or unfunded income. But as regards the point now under discussion it is evident that the Swiss cantons do not really succeed in avoiding double taxation. As we have seen, however, it is a form of double taxation which is in itself legitimate if applied equally to all taxpayers.

III. *Taxation of Property and of Stock*

This third form of duplicate taxation must not be understood to refer to the taxation of shares of stock in the hands of individuals. That is a different problem, and falls under another heading, to be discussed below. The point here to be discussed is this: Is it permissible to tax the corporation on its property and again on its capital stock?

The answer is plain. Manifestly not, if the corporate stock can be regarded as representing actual property. We have, indeed, seen that it is a mistake, economically, to say, as do some of our courts, that the entire property of a corporation is identical with its capital stock. This point has been brought out so well in a Massachusetts case, and is so generally misunderstood, that it may be wise to make a more extended quotation from the decision:—

"The market value of the shares of a corporation . . . does not necessarily indicate the actual value or amount of property which a corporation may own. The price for which all the shares would sell may greatly exceed the aggregate of the corporate property, or it may fall very far short of it. Undoubtedly the amount of property belonging to a corporation is one of the considerations which enter into the market value of its shares; but such market value also em-

braces other essential elements. It is not made up solely by the valuation or estimate which may be put on the corporate property, but it also includes the profits and gains which have attended its operations, the prospect of its future success, the nature and extent of its corporate rights and privileges, and the skill and ability with which its business is managed. In other words, it is the estimate put on the potentiality of a corporation, on its capacity to avail itself profitably of the franchise, and on the mode in which it uses its privileges as a corporate body, which materially influences and often controls its market value." [1]

While it is true, therefore, that capital stock and total property are not interchangeable terms, it cannot be denied on the other hand that the capital stock represents at all events a part of the property, or rather that the corporate property is one of the elements that contribute to the value of the capital stock. So far as this is true, the simultaneous taxation of corporate property and corporate stock involves, to this extent at least, duplicate taxation of an unjust character.

Unfortunately, there is no uniformity in the legal decisions on this point. While the majority of the commonwealths hold taxation of this kind to be unjust, Pennsylvania has pronounced it valid. In a celebrated case the court used this language:—

"Double taxation has never been considered unlawful in this state. The real and personal property of a corporation may be taxed, although it pays a tax on the stock which purchased it. The power of the legislature is as ample to tax twice as to tax once, and it is done daily as all experience shows. Equality of taxation is not required by the constitution." [2]

Such a decision may be correct legally, but beyond all doubt it is unsound economically. Equality of taxation may not be required by the constitution of Pennsylvania, but it is one of the first laws in the science of finance. Abandon equality, and you throw the door wide open to all kinds of glaring abuses. The theory as formulated by the Pennsylvania courts cannot possibly be upheld from the scientific standpoint.

The Pennsylvania courts, however, hold that so far as the capital stock of a domestic corporation represents tangible property outside of the state, it is not taxable.[3] Further, it has also been decided that the real estate of a corporation,

[1] Commonwealth *vs.* Hamilton Manufacturing Co., 12 Allen, 303.

[2] Pittsburgh *etc.*, R. R. Co. *vs.* Pennsylvania, 66 Pa. State, 77. *Cf.* Lackawanna Iron Co. *vs.* Luzerne County, 42 Pa. State, 424.

[3] 101 Pa. State, 119; 41 Legal Intelligencer, 125.

being part of its capital stock and paying state taxes, is not locally taxable.[1] Finally, in another case it has been held that so far as the property of a corporation is essential to the exercise of its corporate franchise, it is included in the capital stock and is not taxable. The law will not subject it to duplicate taxation by mere inference.[2] Thus Pennsylvania is gradually abandoning its earlier decisions.

Far wiser from the very beginning were the Maryland courts, which held that all laws must be so construed as to avoid double taxation of this kind; and that, since in their opinion the capital stock of a corporation represents the corporate property, the payment by the corporation of a tax on capital stock necessarily exempts all the corporate property.[3] In this broad form the decision is perhaps open to criticism because of the complete identification of capital stock with corporate property; but as regards the point at issue here, it is correct. To tax corporations simultaneously on their stock and on their property is indefensible. A few commonwealths, like Alabama, Illinois, Indiana, Vermont and (for local purposes) New York, have now recognized this principle in their statutes, deducting from the value of the capital stock the value of the realty or of both the real and personal property taxed.[4]

On the other hand, the apparently similar statute of Massachusetts, which taxes corporations on their capital stock less the value of the real estate and machinery,[5] is open to criticism for another reason. According to the Massachusetts law, corporations are taxable by the local bodies on their real estate and machinery, but at a rate equivalent to the combined rate for local and state purposes. They are then taxable by the state on the value of their capital stock, deducting the value of the real estate and machinery; but this state tax is fixed at a rate equivalent to the combined local and state rate on gen-

[1] 7 Lane, 317.

[2] 148 Pa. State, 162; 148 Pa. State, 282. See also 145 Pa. State, 96.

[3] County Commissioners *vs.* National Bank, 48 Md. 117. *Cf.* State *vs.* Sterling, 20 Md. 520; State *vs.* R. R. Co., 40 Md. 22.

[4] Ala. Code, § 453, sec. 8; Ill. Rev. Stat., chap. 120, § 3; Ind. Laws of 1891, chap. 4; New York Laws of 1857, chap. 456, § 3, vol. 2, p. 1; Vt. Rev. Laws, § 288. In New York, as we know, corporations are locally taxable on their realty and their capital stock, deducting the amount invested in real estate. The earlier Maryland provision to this effect (Public General Laws, art. 81, §§ 84, 85, 141, 144), has now been abandoned. See 103 Md. 293.

[5] Mass. Pub. Stat., chap. 13, § 40.

eral property. While, therefore, Massachusetts avoids double taxation of both property and stock, it does not solve the problem of affording the commonwealth government an adequate revenue. According to the theory elsewhere elaborated in these chapters, corporations should always be locally taxable on their realty; but the commonwealth tax should be levied on the total income, or on the total property, without any deductions (except those arising from considerations of interstate comity and equity, to be discussed below). The whole treatment of double taxation is here based on the assumption that the tax is levied by administrative units of the same grade, whether state or local divisions. It manifestly does not apply to cases where one tax is levied by the commonwealth, and another similar or different tax is levied by the county or city, as in Massachusetts. Otherwise we should be forced to the conclusion that the property tax always involves a double, triple or quadruple taxation so far as state, county, town and village levy different rates on the same property. This is, however, only a juggle with words; such taxation is not in the scientific sense double taxation. Strictly speaking, therefore, the Massachusetts principle, while ostensibly sound, is really incorrect. So far, however, as it attempts to solve another problem—that of the division of the tax between the place where the corporation carries on its business, and the place where the stockholder resides—the law is deserving of consideration. But that is a point which belongs properly to one of the subsequent sections.

In Switzerland, we find, in the few cases where both tangible property and capital are assessed, that the value of the taxable property is deducted from the corporate capital. Thus the constitution of 1885 in Aargau provides for the taxation of the corporate real estate for both commonwealth and local purposes, the value of the realty being then deducted from the capital stock.[1] The same custom prevails in Schaffhausen.[2] In Germany, Saxony and two of the smaller states are the only ones which permit corporations to deduct from their taxable property not only their debts but also the par value of their capital stock.[3] The Swiss tendency, like the American, is gradually coming to be in accord with the sounder principles.

[1] Schanz, *Die Steuern der Schweiz*, ii., p. 239. *Cf.* the warning above on page 260, note 1.

[2] *Ibid.*, ii., p. 170, note 1.

[3] L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften*, p. 128.

We come now to the most important aspects of double taxation—the fourth and fifth forms. Here we have the benefit of a wide European experience. In the phases of duplicate taxation hitherto treated we can learn very little from Europe, because in no European state except Switzerland and to a minor extent in Germany are corporations taxed on their property as a whole; and in both Switzerland and Germany, as we know, the entire question of corporation taxation is in a very primitive and unsatisfactory stage. But the problems that we now take up present themselves in Europe as well as in the United States, and have there received in some respects extended consideration, although they have not yet been successfully solved.

IV. *Double Taxation due to Conflicts of Jurisdiction*

This fourth form of duplicate taxation appears in connection with almost every method of corporate taxation. It is so comprehensive that it will be advisable to discuss the subject under four chief headings:—

1. Interstate taxation of corporate property.
2. Interstate taxation of stock and bonds or of dividends and interest.
3. Interstate taxation of non-resident stockholders or bond holders.
4. Interstate taxation of corporate receipts or income.

1. *Interstate taxation of corporate property.* The difficulty here arises in connection with the taxation of personal property. In the case of real estate the rule universally adopted in the United States is that the property should be taxed where it is situated, and there is accordingly no chance for interstate complications. But in the case of personalty the great problem is that of *situs*. Should the personalty be taxed where it is situated or should it follow the domicile of the owner? The legal conditions in the United States are most unsatisfactory.

We have seen in another place[1] that the American states waver between the principles of *situs* and of *mobilia personam sequuntur*,—that is, some tax only the personalty actually situated in the state; while others tax all the personalty, no matter where situated, of a resident. The same piece of per-

[1] *Supra*, p. 114.

sonal property may therefore be taxed in two states. The obvious result, of course, is double taxation of a nature which cannot possibly be justified.

In the case of corporations, we are confronted by precisely the same difficulties, for corporate property is treated in the main like that of individuals. It is entitled to the same exemptions and subject to the same conditions. It will be readily perceived, however, with what difficulties the problem is beset when, as is usually the case, the personalty of a corporation is assessed at its place of business as the legal *situs*. In many states, like Michigan, Pennsylvania and New York, it has been held not permissible to tax corporations for property—or at all events for tangible property—outside the state;[1] and in South Carolina the tax is specifically limited to corporate property within the State.[2] In other cases it has been held that the movable property of a corporation in use in other states is taxable only in the state of the corporation's domicile.[3] In Pennsylvania, it has been held that corporate property, consisting of dredges, *etc.*, not permanently located anywhere, may be taxed in the state of the corporation's domicile as part of the stock.[4] Some states, like New York and California, apply the same rule to corporate as to individual property, and seek to avoid double taxation of this kind. In New York, in order to exempt the personal property of a corporation because it is outside of the state, the change of location must be permanent and unequivocal.[5] But in most of the states the rule *mobilia personam sequuntur* is applied, and domestic corporations, at all events, are taxed on their whole property.[6] In the case of foreign corporations, however, it is fast

[1] State Treasurer *ex rel. vs.* Auditor-General, 46 Mich. 224; Graham *vs.* Township of St. Joseph, 67 Mich. 652.

[2] S. C. Rev. Stat. chap. 12, sec. 28. For other cases, see Commonwealth *vs.* Railroad Co., 145 Pa. State, 96, distinguishing Commonwealth *vs.* Dredging Co., 122 Pa. State, 386; Commonwealth *vs.* Westinghouse Air Brake Co., 151 Pa. State, 276; Commonwealth *vs.* St. Bernard Coal Co., 9 Southwestern Reporter, 709 (Ky.).

[3] Baltimore and Ohio R. R. Co. *vs.* Allen, 22 Fed. Rep. 376.

[4] Commonwealth *vs.* American Dredging Co., 122 Pa. State, 386.

[5] People *ex rel.* Pacific Mail S. S. Co. *vs.* Commissioners, 64 N. Y. 541. As to how the realty outside the state should be valued, see 52 Hun, 93; People *ex rel.* Panama R. R. Co. *vs.* Commissioners, 104 N. Y. 240 (1887). For California, see San Francisco *vs.* Fry, 63 Cal. 470 (1883); San Francisco *vs.* Flood, 64 Cal. 504 (1884).

[6] This was formerly the case also in New Jersey, where personal property

becoming the custom, even in most of the states which levy a corporate property tax, to exempt the intangible property, on the principle that the domicile of the foreign corporation is not changed by its doing business in other states.[1]

Manifestly, if the commonwealths will still cling to the policy of taxing the actual corporate property, the only logical and just method is for each state to exempt so much of the corporate property as is already taxable in another state. The federal government has unfortunately not exercised its right—if indeed it possesses any—to compel such uniformity. Our only hope, therefore, lies in the progress of correct public sentiment and its influence on commonwealth legislation. Until then, we shall still be confronted by the present confusion.

2. *Interstate taxation of corporate securities.* The evils arising from the simultaneous taxation by different states of the same corporate stock or bonds or dividends and interest have been so patent as to lead to statutory changes and judicial interpretations of considerable importance. In Pennsylvania, after being long the custom, it was subsequently judicially decided to be the law, that the tax on capital stock applies not to the whole capital but only to such a proportion of the capital stock as is employed, either actually or constructively, within the state.[2] The act of 1907 applied the same principle to the bonus on charters. In New York, the original statute attempted to follow the old rule; but the law was subsequently so amended as to provide expressly for the taxation of only so much of the capital stock as is employed within the state.[3] In a case which arose under the old statute, although decided after the passage of the amendment, the court of appeals declared itself forced to adhere to the old rule, saying that, although it was extremely hard and unjust, the court was unable so to construe the statute as to relieve the corporation from the provisions of the law.[4] The principle in both these common-

outside of the state, which was exempt in the case of individuals, was taxable when owned by corporations. State *vs.* Metz, 3 Vroom, 199; State *vs.* Haight, 6 Vroom, 279. This was however altered by subsequent legislation. *Cf.* the N. J. Revised Tax Act of 1903, sec. 3.

[1] *Cf.* Insurance Co. *vs.* Assessors, 44 La. Ann. 760. *Cf. ibid.*, 765.

[2] Commonwealth *vs.* Standard Oil Co., 101 Pa. State, 119. As to the previous custom, *etc.*, see *Decisions of the Auditor-General*, 1878–80, p. 296.

[3] New York Laws of 1885, chap. 501, p. 858.

[4] People *vs.* Horn Silver Mining Co., 105 N. Y. 76, especially 88.

wealths now applies equally to domestic and to foreign corporations. In Massachusetts, however, where the franchise tax, as we have seen, is applicable only to domestic corporations, the general corporation tax is levied on the total capital stock irrespective of its employment.

So far as railroads are concerned, it has become the common practice to assess only so much of the capital stock as is represented by the proportion which the mileage in the state bears to the total mileage. This is true even in states like Massachusetts, which do not apply the principle to corporations in general, as well as in states like Connecticut, where stock and bonds are taxable. Such a standard, while not perfectly exact, is fairly accurate; and has been upheld as entirely constitutional.[1] It is applicable equally to telegraph companies and to other transportation companies; and is gradually being applied to them, although not quite so commonly as in the case of railroads, in all those states which tax capital stock directly. The principle is sound, although it may be contended with justice that business done, *i.e.* receipts, is an even better test than mileage, even though mileage would have to be one of the factors employed in apportioning receipts.

For other corporations, however, it will readily be seen how vague is the New York and Pennsylvania doctrine of "capital employed within the state." What business firm or corporation with ramifications all over the country can tell exactly or even approximately how much of its capital is "employed" within any one state? Even if they can, how many of them will tell, when concealment will enable them to evade the tax? In some of our commonwealths the state officers have the right to inspect the books of corporations and to change the assessments if they deem them too low. Even then, what guarantee is there that they will discover the real proportion? The taxation of so much of the capital as is employed within the state is extremely difficult.

Because of the fact that many states still follow the old New York practice it may be interesting to notice some New York decisions of cases which occurred before the present amendments were adopted. A Massachusetts corporation—a telephone company—was taxed in New York by assessing the whole capital in proportion to the number of telephones used in the

[1] Delaware Railroad Tax Case, 18 Wall. 208; Erie Railroad *vs.* Pennsylvania, 21 Wall. 492.

state. Although the tax was declared invalid for quite another reason, *viz.*, that the corporation was not technically "doing business" in the state, the court entered into a discussion, *obiter* indeed, of the question with which we are dealing here. Chief Justice Ruger used the following language:—

"It is by no means clear that the mode adopted . . . produces a correct result. . . . We are quite unable to sanction a principle which would subject it [the corporation] to the liability of being taxed, not only in [the state] where it is located, as it undoubtedly would be under the law as laid down by us [in the Horn Silver Mining Company Case], on its entire capital stock and gross earnings; but also in each state of the Union in which it should own telephones on such proportion of its capital stock and gross earnings as the law-makers of such state saw fit to impose.[1]

It is difficult to see the justice of this conclusion. It happens that Massachusetts until 1885, still followed the incorrect and inequitable plan of taxing the whole capital. But that was no excuse for the New York court to interpret the old statute in the same way, or to assume that other states will also follow the precedent which the court itself pronounced "extremely hard and unjust." Two wrongs do not make a right. In the absence of any federal law regulating the subject, the only upright course for each commonwealth to pursue is to follow the dictates of interstate comity and the sound principles of the science of finance by taxing only so much of the corporate capacity as is, economically speaking, within its jurisdiction. As we have repeatedly said, the taxation of corporate stock is by no means the ideal method. But if the New York principle of taxing capital stock and gross earnings be nevertheless followed, it is difficult to discover any more practicable or more defensible method of ascertaining the due proportion of capital stock employed or gross profits earned within the state than by considering the number of, or royalties from, the telephones used. This is analogous to the Connecticut system of proportional mileage as applied to railroad companies. In the case of telephone companies, however, the number of instruments used is a better test than the mileage of the telephone wires; for the capital, as well as the expenditure, is far more nearly in direct proportion to the number of telephones in use than to the amount of wire employed.

In the above case the law was declared invalid because the

[1] People *vs.* American Bell Telephone Co., 117 N. Y. 242, especially 256.

tax was assessed on a foreign corporation. Even though this foreign corporation held stock in various domestic corporations, it was not legally doing business in the state; since before a foreign corporation can be taxed under the New York law it must not only employ a portion of its capital in that state, but must also be engaged in doing business there.[1] In the case of a domestic corporation the fact that the capital is employed within the state is a sufficient ground for taxation. So far as its capital stock is invested in the stock of foreign companies, it is not taxable because it is not employed within the state; but so far as its capital is invested in the bonds of foreign corporations taken in return for the sale of patent rights, it is taxable.[2] In another case which also arose under the old law it was held that the proportion of sales within the state to the total sales of a foreign corporation is not a fair test of the capital employed within the state. Sales may be made by sample, so that the corporation may simply keep an office in the state and employ none of its capital there.[3]

3. *Interstate taxation of non-resident bondholders or stockholders.* The subject of the taxation of corporate stock or bonds is complicated in another way by the question of extra-territoriality. The problem is this: Can a corporation, even though its capital be employed wholly within the state, be taxed on its capital or bonded debt if these are owned in part by residents of another state?

The federal Supreme Court has arrived at some very remarkable conclusions. So far as bonds are concerned, the above practice has been pronounced unconstitutional. In one case it has been held that a state tax on bonds issued by a railroad company and secured by a mortgage on a line lying partly

[1] Am. Construction and Dredging Co. *vs.* Wemple, 129 N. Y. 558 (1892).

[2] Edison Electric Light Co. *vs.* Campbell, 139 N. Y. 543 (1893).

[3] The Seth Thomas Clock Co. *vs.* Wemple, 133 N. Y. 323 (1892). For a suggestive treatment of this topic see the Report of the Committee on the Taxation of Public Utilities and upon the Interstate Apportionment of the Tax in *Proceedings of the 16th Conference of the National Tax Association*, 1924, p. 403. The committee recommends the use of a composite criterion composed, for railroad companies, of all-track mileage, car mileage, physical valuation, traffic units, and gross earnings; for street railways, of salaries and wages, gross receipts and mileage; for telephones, of time and distance as affecting the relative use of the wires. For general business corporations see below, p. 294.

in another state was void, because the state was taxing to that extent "property and interests beyond her jurisdiction." [1] A later case went further and decided in general terms that a tax on corporate bonds is invalid as to non-resident owners, because the debts are the property not of the debtor, *i.e.* the corporation, but of the creditors, *i.e.* the bondholders. They are the obligations, not the property, of the debtors. But the creditors cannot be taxed on their property because they are not within the jurisdiction of the state.[2] The particular statute in this case was the Pennsylvania law of 1868, requiring corporations to retain five per cent on the interest due on the bonds, payable to non-residents. The state courts which had hitherto entertained a different opinion were compelled to acquiesce; and in a later case, decided in the same commonwealth, the state tax on corporate loans, *i.e.* on bonded indebtedness, was upheld only so far as it applied to the bonds owned by the residents,[3] being declared to be a tax on the bondholder, not on the corporation.[4] This, therefore, is the accepted law of the land as to bonds.

Shares of stock, on the other hand, are treated quite differently. It has indeed been decided that a state tax on dividends is unconstitutional as to non-residents if the corporation be required to withhold the tax from the dividends.[5] The New Jersey courts, moreover, have held that a corporation is not liable on that part of its stock owned by non-residents.[6] The United States courts, however, have uniformly maintained that a state tax on capital stock, even though the stock be held partly by non-residents, is legitimate on the ground that the tax is laid on the corporation as a whole, and not on the individual shareholder.[7] A later case even decided that a state tax on the shares of stockholders, which the company is required to pay irrespective of dividends, is not a tax on the shareholders but on the corporation.[8] This is held to be true

[1] Railroad Company *vs*. Jackson, 7 Wall. 262.
[2] State Tax on Foreign-held Bonds, 15 Wall. 300.
[3] Commonwealth *vs*. Delaware Division Canal Co., 123 Pa. 594.
[4] Bell's Gap R. R. Co. *vs*. Commonwealth, 134 U. S. 232.
[5] Oliver *vs*. Washington Mills, 11 Allen, 268.
[6] 26 N. J. 181; 3 Zabriskie, 506, 517.
[7] Delaware Railroad Tax Case, 18 Wall. 208.
[8] New Orleans *vs*. Houston, 119 U. S. 265. *Cf.* also 196 U. S. 466, upholding the Maryland tax on non-resident stockholders. See Corry *vs*. Baltimore, 96 Md. 310.

notwithstanding the fact that in another case a tax on dividends or interest paid by the corporation was held to be a tax on the income of the stockholder or of the creditor, and not on the income of the corporation.[1]

The present state of the law, therefore, is that the entire capital stock of a corporation may be taxed by any commonwealth, but that only so much of the bonds are taxable to the corporation as are owned by residents of the state. The mere statement of this proposition makes it evident how impracticable would be the otherwise defensible system of taxing corporations by a separate tax on stock and an additional tax on bonds. The Pennsylvania system, which at first blush seemed to be an excellent solution of the problem, thus appears to be shorn of its chief merits, if the present law of the land is sound. The great majority of states, the bonds of whose corporations are owned mainly outside of the state in large financial centres like New York or Boston, would find such a tax sadly inadequate.[2] Even in the state of New York, where for several

[1] United States *vs.* Railroad Co., 17 Wall. 332.

[2] An investigation by the Pennsylvania Tax Conference disclosed the following facts as to certain Pennsylvania railroads:—

Total Bond Issues	Amount held in Pa.	Appraised Value of Stock	Percentage of Line in Pa.
$ 450,000	$ 116,000	$ 450,000	100
352,000	63,000	1,400,000	"
72,800	2,700	383	"
230,000	——	384	"
240,000	8,000	48,000	"
320,000	——	121,100	"
5,250,000	1,200,000	3,388,550	"
890,000	——	1,400,000	"
990,000	80,000	1,278,300	"
3,400,000	6,000	2,000,000	"
2,900,000	——	127,000	50
——	——	800,000	100
——	——	3,546,670	"
179,000	179,000	144,375	"
2,280,000	2,100,000	2,900,000	"
495,000	456,000	1,850,000	"
500,000	410,000	650,000	"
200,000	200,000	80,000	"
1,800,000	1,800,000	600,000	"
800,000	800,000	800,000	"
270,000	260,000	2,370,466	"
300,000	300,000	——	"
275,000	——	——	"
——	——	642,000	"

years the comptroller clamored for a tax on corporate indebtedness, the proceeds would fall far below the actual capacity of the corporations. The decisions of the Supreme Court prevent double taxation, it is true, but they do it so effectually as also to prevent just taxation.

The same difficulty applies to the taxation of bonds of foreign corporations held in the state. A recent case has decided that a state cannot impose upon a corporation chartered by another state, when paying in that other state the interest due upon bonds held by a resident of the first state, the duty of deducting from the interest so paid the amount assessed upon the bonds by a tax law of the first state.[1]

From the economic point of view, these decisions are indefensible. If the tax on capital stock is a tax on the corporation, then the tax on mortgage bonds is equally a tax on the corporation. Stock and bonds together represent the corporate property, for the value of the stock is diminished by the existence of the bonds. The bondholders, viewed from the economic standpoint, are no more creditors of the corporation than are the stockholders. They are co-proprietors, just as mortgagor and mortgagee are in economic fact co-owners of the land. It is, therefore, difficult to see any justification for taxing non-resident stockholders while exempting non-resident bondholders. The same rule should be applied to both classes, for their interests in the prosperity of the corporation are in this respect precisely the same. The original Pennsylvania decision which was reversed by the federal Supreme Court rested on an earlier case involving much the same question, known as Maltby's Case. And with all due deference to the Supreme Court, it must be stoutly maintained that to the student of political economy the original Pennsylvania decision seems sounder than that rendered by the federal tribunal. In Maltby's Case the court uses the following language:—

> "What would the plaintiff's [a non-resident] loan be worth if it were not for the franchises conferred upon the corporation by the commonwealth [of Pennsylvania], franchises which are maintained and pro-

Some of the results are very absurd: Railroad no. 4, although having $230,000 bonds, paid a tax of $1.92. Road no. 18, worth about the same amount, paid $1,200. The last road but one paid no taxes at all. The road half of whose mileage was in the state paid nothing at all on its $2,900,000 bonds.

[1] Railroad Co. *vs*. Pennsylvania, 153 U. S. 629.

tected by the civil and military power of the commonwealth. . . . It is on this ground that the legislature discriminates between corporation loans and private debts as objects of taxation. . . . *The loans and stocks of a railroad company resemble each other in many respects.* Both are subscribed under the authority of a special law, and *both are so far capital* that they are employed for the same general purpose. . . . Although loans and stocks are distinguishable for many purposes, yet the legislature committed no very great solecism in treating loans as taxable property within our jurisdiction. . . . Corporation loans, though in one sense mere debts, are, like moneys at interest, taxable as property."[1]

This is perfectly sound economics, although it is not now the law of the United States.

It is remarkable that, in several cases decided since the leading case of the state tax on foreign-held bonds, the Supreme Court has applied to the relations between the federal government and foreign states a principle entirely different from that which it invoked in the case of the commonwealths. It has been held that the national tax imposed during the Civil War on the dividends, coupons and profits of transportation companies is an excise tax on the business, and that it is valid even though the dividends or interest are withheld from a foreign stockholder or bondholder.[2] Justice Field in a dissenting opinion showed the incongruity between these decisions and the earlier ones as applied to commonwealth laws. He said:—

"If the United States can do this, why may not the state do the same thing with reference to the bonds issued by corporations created under their laws? What is sound law for one sovereignty ought to be sound law for another."[3]

This protest, however, was in vain, and the legal status of the problem continues to be anomalous. The federal government can impose a tax on the total stock and bonds, or total dividends and interest of corporations, irrespective of the residence of the holders. The separate commonwealths, on the other hand, which are treated like foreign countries in the case of corporate stock or dividends, can impose a tax on only so much of the bonds or interest as are owned by, or due to, residents. This is of course illogical.

[1] Maltby *vs.* Reading and Columbia Railroad Co., 53 Pa. State, 140.

[2] Railroad Company *vs.* Collector, 100 U. S. 595 (1879); United States *vs.* Erie Railroad Co., 106 U. S. 327 (1882).

[3] 106 U. S. 335.

A peculiarly interesting complication arises in those commonwealths where the law of mortgage has been changed for tax purposes. One of the chief grounds of the decision in the Foreign-held Bond Case was that the railroad lands on which the bonds and mortgages were issued lay in Pennsylvania, and that the non-resident bondholder had no property therein. Said Justice Field:—

"The property in no sense belonged to the non-resident bondholder or to the mortgagee of the company. The mortgage transferred no title; it created only a lien upon the property. Though in form a conveyance, it was both in law and equity a mere security for the debt. The mortgagee has no estate in the land."

It would be interesting, if this were the proper place, to trace the law of mortgage through both the Roman and the English law, and to show that in each system the mortgagee originally had both possession and property; that in a later stage he had no property in the land but retained the possession; until finally he had neither property nor possession, but simply a lien.[1] Be that as it may, it is true that Justice Field correctly represented the American law on the subject. That the mortgagee has no estate in the land is the Pennsylvania law;[2] and similar cases have been decided in the same way in other commonwealths. Thus, in an Iowa case, a corporation mortgage held by a non-resident was declared non-taxable in Iowa because "the mortgagee has only a chattel interest. . . . The mortgage is personal property . . . and attaches to the person of the owner."[3] So also under the old constitution of California, a case of intermunicipal taxation was decided in the same way. A judgment of record in one county upon the foreclosure of a mortgage situated in that county, the owner of the judgment being the resident of another county, was held not taxable in the first county because "the thing secured by the mortgage is intangible and has no *situs* distinct and apart from the residence of the holder. It pertains to and follows the person."[4]

[1] For the Roman law of *fiducia*, *pignus* and *hypotheca*, see Hunter, *Roman Law*, pp. 262–276. For the development of the English law, see Digby, *An Introduction to the History of the Law of Real Property*, chap. v., § 5 (2).

[2] Rickert *vs.* Madeira, 45 Pa. State, 463.

[3] Davenport *vs.* The Mississippi and Missouri Railroad Co., 12 Iowa, 539.

[4] People *vs.* Eastman, 25 Cal. 603. See also State of Nevada *vs.* Earl, 1 Nevada State, 397; State *vs.* Ross, 3 Zabriskie, 517.

It will be seen that all these cases turn upon the point that the mortgage is personal property; but in several commonwealths, as we know,[1] it has been provided that the interest of the mortgagee should be considered, for purposes of taxation only, as realty. This changes the whole situation and entirely undermines the foundation of the decision in the Foreign-held Bond Case. If the interest of the non-resident bondholder, *i.e.*, the mortgagee, is no longer personalty, it does not follow the person of the bondholder, but may be taxed by the commonwealth in which the corporation is situated. The taxation of non-resident bondholders must thus be assimilated in these states to that of non-resident stockholders, and the federal decision will therefore be applicable to one part, but inapplicable to another part, of the United States. It may even happen that the corporate property covered by the mortgage is situated in several different states, so that part of the bonds may be subject to one law, part to another. The ensuing complications may be easily imagined. It would be far better for the Supreme Court to abandon the whole contention and on purely economic grounds to reverse its decision. In assessing a tax on capital stock or bonded debt, it should be entirely immaterial whether or not some of the stockholders or bondholders live without the state. The residence of the security holder should have nothing to do with the taxation of the corporation.

If the tax is imposed not on the corporation but on the shareholders, non-resident stockholders would naturally escape, because outside the tax jurisdiction. In some cases, however, it is provided that corporations must then pay taxes for the non-resident stockholders.[2]

From one point of view there is indeed some force in the contention that the residence of the security holder should be considered. It may often occur that the stock and bonds of a corporation lying within one state may be owned by residents of another state. If the whole fortune of these individuals is invested in such securities, the second state would get no revenue at all if it exempted securities of taxed corporations. Yet the individuals certainly owe some duty to the state of their residence; their economic allegiance, so to speak, is partly due to the state where they live. On the other hand, it is equally

[1] *Supra*, p. 104.

[2] Md. Rev. Code, part viii., art. xi., § 87; N. J. Rev., 1877, p. 1199 (as to banks); Ore. Gen. Laws, 1872, chap. 57, art. 1, § 6.

clear that the corporation owes a decided duty to the state where it is situated and where its earnings are secured. How is this conflict to be avoided?

The most desirable solution of the difficulty, as we have already intimated, would seem to be the division of the tax between the state of the corporation and that of the security holder. Each party possesses taxable faculty or ability within the borders of the respective states—the corporation where it earns its money, the security holder where he resides and enjoys the benefit of government. For each state to levy the entire tax would be double taxation; hence, if one party is taxed, the other should be exempt. In order to obviate the complete loss of revenue to the one state, and to satisfy the conflicting claims, the principle of economic allegiance must be invoked, and each state must be permitted to tax that portion of the economic faculty that properly falls within this category. This of course must be arranged by interstate agreement. The plan has not yet been tried in any American state, because no serious attempt has yet been made to grapple with the difficulties; yet no final escape from the complexities of double taxation can be attained until some such method is adopted. But even though the proceeds ought to be so divided, the tax ought to be levied as a whole, entirely irrespective of the residence of the security holder. This part of the problem may be solved according to the system proposed by the Tax Conference of Pennsylvania and practised in some other states, like Illinois, Indiana and Connecticut; namely, by assessing the corporation on a valuation equal to the market value of the whole capital stock plus the entire bonded debt, with a provision that only so much of the capital shall be assessed as is economically within the state.

4. *Interstate taxation of receipts or income.* This phase of interstate double taxation presents far less difficulty. In regard to gross receipts the measure of faculty is very simple, *viz.*, the gross receipts from business done within the state. In the case of insurance companies this is fast becoming the general rule in this country. When the returns do not show the precise amount of the gross receipts, the laws often provide, especially in the case of transportation companies, that the "gross earnings within the state" should be deemed to be that proportion of the entire gross earnings which the mileage within

the state bears to the total mileage. This is the definition in Maine and many other states, and it has generally been upheld.[1] Under this definition the question has sometimes arisen whether the word *mileage* is to be interpreted to mean miles of track or miles of line. The former is, obviously, the correct economic basis, for the more double tracks, sidings and spurs, the denser usually is the traffic. In Wisconsin mileage has been held to include side tracks.[2] The mileage principle has also been applied to street railway companies, in the assessment of lines within and without the city limits.[3] An interesting variation is found in the Virginia law imposing the gross receipts tax on railroads which adds a proviso making an allowance "for a reasonable sum because of any excess of value of the terminal facilities or other similar advantages situated in other states over similar facilities or advantages situated in this state."

Another definition of "gross earnings within the state" which obviates this whole question of double tracks, allowances, *etc.*, has been adopted by Minnesota and more recently by California. Thus to quote the California law "gross receipts within the state shall be deemed to be all receipts on business beginning and ending within this state, and the proportion based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into or out of the state." Mileage in this case means simply the distance a given shipment is hauled. If we compare the so-called Maine system with the so-called Minnesota system it may be said that while the former is really the simpler, the latter is on the whole more equitable in that it does not attempt to get any taxes or traffic beyond its own limits.[4] As to other than transportation corporations the gross earnings tax can be easily arranged so as to obviate double taxation.

If in lieu of the gross earnings tax a tax on net receipts or income be imposed, how does the matter stand then? Strictly speaking, only so much of the income as is earned within the state should be assessed; but since it is exceedingly difficult to apportion the expenses of a large corporation among all its

[1] 18 Wall. 208, 231. *Cf.* 92 U. S. 608; 125 U. S. 530; 45 Md. 384; 141 U. S. 18; 55 Fed. Rep. 206.

[2] 64 Wis. 130.

[3] 74 Md. 405.

[4] *Cf.* for a discussion of the two methods *Report of the California Commission on Revenue and Taxation*, 1906, pp. 171–174.

branches in different commonwealths, it would seem preferable to adopt some approximate standard by which the net receipts could be measured. All sorts of criteria have been attempted in the various states imposing an income tax, some of them of a very intricate nature.[1] There is ample room for the elaboration of a practicable and easily ascertained measure.

We have thus far considered only the question of complications arising from international or interstate taxation. Of minor consequence, but still of sufficient importance to deserve mention, are the problems of intermunicipal double taxation. These are of minor consequence because, in the United States at least, there are, with the exception of street car lines, few instances of local taxes on the receipts of corporations which do any business without the limits of the local divisions. On the other hand, we find local taxes on the total property and on the capital stock of corporations which have more than a purely local significance. The rules should be the same as those applied above to cases of interstate taxation.

What can Europe teach us? The chief countries in which such interstate complications have arisen were the federal states of Germany, Austria-Hungary and Switzerland. In two of these an attempt has been made to regulate the matter.

[1] The New York law prescribes three criteria: (1) The average monthly value of the realty and tangible personalty within the state; (2) the average monthly value of bills and accounts receivable; (3) the proportion of the average value of the stocks of other corporations owned. In Massachusetts, after deducting interest and dividends due to citizens of the state and gains from the sale of real estate or tangible personalty within the state, the remaining income is divided into three parts according to the relative proportion within the state of (1) tangible property, (2) wages, salaries and commissions, and (3) gross receipts from sales, rentals or royalties. In Wisconsin the numerator of the fraction is obtained by adding to the book value of all property owned within the state (less certain items) the gross sales in the state; then subtracting the factory cost of goods sold in the state, and adding factory and all products manufactured in the state. The denominator is found by applying the same process to property and business everywhere. The Report of the Committee on the Apportionment between States of Taxes on Mercantile and Manufacturing Business (*Proceedings of the 15th Conference of the National Tax Association*, 1923, p. 198) recommends the allocation as to interest, dividends, rents and royalties according to the place of business in connection with which they are received; as to gains from the sale of capital assets according to the location of the property, and as to the income from manufacture or sales partly according to the value of the tangible property and partly according to wages, cost of materials and receipts from sales.

In Switzerland the constitution of 1874 imposes on the federal legislature the obligation of preventing double taxation, without attempting, however, to analyze or to point out the various forms of double taxation.[1] While several decisions of the Swiss courts have definitely settled some of the simpler problems of duplicate taxation, the more subtle questions that interest us under this fourth heading have not yet been adjudicated to any extent. Beyond the principle that corporations, like natural persons, are taxable on their income and on their property by the canton where their chief office or establishment is situated, or where their business is conducted, no successful attempt has as yet been made by the federal legislature or courts to solve the problems here discussed.[2] A few of the cantons, however, have recently embodied in statutes the principle that only so much of the capital or income as is employed or received within the commonwealth should be taxable. Such, for instance, is now the law in Vaud, Ticino and Baselstadt.[3] In Bern the same principle is applied to intermunicipal taxation.[4] In Uri the taxable property and

[1] Art. 46: "Die Bundesgesetzgebung wird . . . gegen Doppelbesteuerung die erforderlichen Bestimmungen treffen."

[2] Zürcher, *Kritische Darstellung der bundesrechtlichen Praxis betreffend das Verbot der Doppelbesteuerung* (Basel, 1882), pp. 88–93; Schreiber [same title], p. 259. *Cf.* also, in general, Speiser, *Das Verbot der Doppelbesteuerung*, Basel, 1886; and the chapters on double taxation in W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz*, Bern, 1906; and the book of Schwarzmann, mentioned on p. 145.

[3] In Vaud, all individuals as well as private corporations or societies, "sont soumis à l'impôt pour tout le capital mobilier affecté au service de leur activité dans le canton." Loi d'impôt sur la fortune mobilière et sur la fortune immobilière, du 21 août, 1886, chap. iii., art. 12. Printed in Schanz, *Die Steuern der Schweiz*, v., p. 387; *cf.* also, iv., p. 128.—In Ticino, "le persone, le ditte commerciali, le società o gli enti morali in genere, che, non avendo il loro domicilio o la loro sede nel Cantone, vi tegono stabilimento, succursale, agenzia, rappresentanza, o vi esercitano un' industria, oppure vi poseggono beni o rendite . . . sono tenuti al pagamento dell' imposta, in ragione della sostanza e della rendita che hanno nel Cantone." Legge sull' imposta cantonale (April 28, 1890), art. 14. In Schanz, v., p. 462.—In Baselstadt, "bei Gesellschaften welche neben der Niederlassung im Kanton auch eine solche ausserhalb des Kantons besitzen, tritt eine dem Umfange der auswärtigen Niederlassung entsprechende Minderung des Steuerbetrags ein." Gesetz betreffend die Besteuerung der anonymen Erwerbsgesellschaften, vom 14 Oktober, 1889, § 4. In Schanz, v., p. 50.

[4] "Bei Unternehmungen, die in verschiedenen Gemeinden ihr Gewerbe ausüben, ist die Steuer nach Verhältniss der Ausdehnung des Geschäfts an diese Gemeinden zu entrichten." Gesetz über das Steuerwesen in den Gemeinden, vom 2 Sept., 1867, § 7. In Schanz, v., p. 88.

profits are calculated in proportion to relative mileage.[1] In Neuchâtel foreign corporations are taxable only for the profits earned within the commonwealth.[2] In Appenzell it is provided that corporations should pay the income tax in the place where the business is carried on, but in such a manner as to avoid double taxation.[3] The law of Ticino is especially interesting for the further reason that it also imposes a tax on all corporate loans, but allows the corporation to deduct the tax only from the interest on the bonds owned within the canton.[4] Foreign-held bonds thus escape taxation in the hands of the individual holder except by the state of the owner's residence.

In Germany, the conditions are much the same. In 1870, an imperial law was enacted which forbade in express terms double taxation arising from interstate complications. This law provided that individuals should be taxed by the state of their domicile, and that real estate should be taxable by the state of its location. The only clause affecting corporations prescribed that the occupation as well as the income from the business could be taxed only by the state where the business was carried on.[5] The commission which drafted the law, however, evaded the main question by asserting that the exact proportion of the corporate business or income taxed by any one state must depend on "the particular form of the actual conditions."[6] This has settled nothing, and the matter remains, as before, a subject for the separate states to regulate.

[1] Uri, Steuergesetz vom 10 Mai, 1886, art. 13. In Schanz, v., p. 376.

[2] "Les sociétés anonymes . . . sont soumises au même impôt pour les ressources que leur procurent les affaires faites dans le pays." Loi sur l'impôt direct du 18 octobre, 1878, art. 6, § 3. In Schanz, v., p. 219.

[3] "Immerhin unter Vermeidung von Doppelbesteuerung." Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 1880), art. 6. In Schanz, v., p. 26.

[4] The corporations "sono tenuti al pagamento dell' imposta . . . sull' importo complessivo delle obbligazioni al portatore da loro emesse." But the law contains this further provision: "Non saranno colpiti dall' imposta i capitali [including the bonds] di cui . . . ove il contribuente dimostri che ció costituirebbe una doppia imposta." . . . Arts. 15 and 3, § 3 of the law of 1890. In Schanz, v., pp. 460, 462; *cf.* iv., p. 282.

[5] Reichsgestz wegen Beseitigung der Doppelbesteuerung; vom 13 Mai, 1870, § 3. Reprinted in Meitzen, *Die Vorschriften über die Klassen- und klassifizierte Einkommensteuer in Preussen*, no. 6.

[6] "Dass die Entscheidung immer von der besonderen Gestaltung der tatsächlichen Verhältnisse abhängen werde." *Cf.* Clauss, "Das Reichsgesetz wegen Beseitigung der Doppelbesteuerung," in Schanz's *Finanz-Archiv*, v., pp. 138–197, especially p. 179.

Several of the German commonwealths have now adjusted the difficulties in very much the same way that has been adopted or proposed in various American states. Thus the Baden law provided that only so much of the corporate income shall be assessed as is proportional to the amount of capital employed within the state.[1] So the earlier Prussian law provided that the taxable net income of railroads which lie partly in other states should be estimated by the proportion of gross receipts within the state, and that this again should be calculated according to mileage.[2] The Prussian local law tax of 1885 measures the proportion of corporate income or net profits due to each tax district by the share of gross receipts in the case of banks and insurance companies, and by the share of expenses for salaries and wages in the case of transportation companies.[3] The income-tax law of 1891 states that only that part of the net receipts actually earned in Prussia shall be taxable.[4]

The tendency therefore seems to be the same in all countries. Whether the tax be imposed on property or on income, the law should be applicable to both domestic and foreign corporations; and while no deduction should be made for non-resident holders of stock or bonds, only so much of the property or income should be assessed as is employed or received within the state. Since an exact standard is unattainable, it is advisable to use the approximate test of relative mileage in the case of transportation companies and of relative gross receipts in the case of other corporations.

V. *Taxation of the Corporation and of the Security Holder*

We come finally to the fifth and most important division in the subject of duplicate taxation—the taxation of the corporation and of the shareholder or bondholder. The question is: If we tax the corporation, shall we also tax the individual who owns the stock or bonds of the corporation? Is this double taxation? Is it unjust?

[1] Badisches Einkommensteuergesetz von 20 Juni, 1884, art. 5, lit. B. In *Finanz-Archiv*, iii., p. 368.

[2] Law of March 16, 1867, § 9. For the judicial decisions and rescripts on this point, see Clauss, *op. cit.*, p. 181.

[3] Communalsteuernothgesetz von 27 Juli, 1885, § 7. Printed in *Finanz-Archiv*, iii., pp. 174–193, together with an explanatory article by Secretary Herrfurth.

[4] Einkommensteuergesetz von 24 Juni, 1891, § 16.

Let us first discuss the actual practice both here and abroad. In the United States the legal conditions are absolutely lacking in uniformity. In some states the tax on the corporation is declared to be a tax on the shares, which are accordingly exempted from assessment. Thus in California, the statute declares that "shares of stock possess no intrinsic value over and above the actual value of the property of the corporation for which they stand," and that to tax both corporation and shareholder is double taxation.[1] In Arizona, we find exactly similar language used.[2] In most of the other commonwealths, also, shares of stock in the hands of individuals are exempt when the corporation itself is taxed, although the reason of the rule is not always expressly stated as in the cases just cited.

On the other hand, the statutes in North Carolina, Wyoming and Iowa (except for manufacturing corporations) and the judicial decisions in Illinois, Iowa, Louisiana, Maine and Maryland are to the contrary effect.[3] This was formerly true also in Indiana, Pennsylvania and Tennessee.[4] In some of these cases it has been held that "the tangible property of a corporation and the shares of stock are separate and distinct kinds of property under different ownership; the first being the property of the corporation and the last the property of the individual stockholder." Taxation of both corporation and shares of stock is hence pronounced neither duplicate nor unjust taxation, even though the shares of stock have no value save that which they derive from the corporate property and franchise.[5] In other cases again, it has been held that even though the taxes amount to double taxation, they are not unconstitutional. This, however, is true only in those states

[1] Cal. Code, § 3608, new sec. March 7, 1881; *cf.* Burke *vs.* Badlam, 57 Cal. 594; 21 Fed. Rep. 539; 22 Fed. Rep. 602.

[2] Ariz. Code, § 2633.

[3] Porter *vs.* Railroad Co., 76 Ill. 561; Danville Banking Co. *vs.* Parks, 88 Ill. 170; Cook *vs.* Burlington, 59 Ia. 251; New Orleans *vs.* Canal Co., 32 La. Ann. 51; Cumberland Marine Railroad *vs.* Portland, 37 Me. 444. Wilkens *vs.* Baltimore, 103 Md. 293, and Baltimore *vs.* Alleghany Co., 99 Md. 1.

[4] 15 Ind. 150; 49 Pa. State, 526; 66 Pa. State, 77; 47 Pa. State, 106. But it has been recently held in Pennsylvania that double taxation will not be supported except by express enactment. 156 Pa. State, 488; 151 Pa. State, 265 and 276; 139 Pa. State, 612.

[5] So also in Switzerland this simultaneous taxation has been upheld on the strictly juristic ground that the corporation and the shareholder are distinct persons. See Speiser, *Das Verbot der Doppelbesteuerung*, and Roguin, *La Règle de Droit* (Lausanne, 1889), 141 and *passim*.

which admit double taxation, as Pennsylvania formerly did, even though it be confessedly unequal.

Other commonwealths, again, take a less logical middle ground. In the case of certain corporations they do not permit taxation of both shares and corporation; in the case of other corporations they do not object to this simultaneous taxation. In the case of national banks, as we know, the taxation of the corporation itself is made impossible by federal law. Most of the states, therefore, tax only the individual shares, although they collect the tax through the corporation.[1] In many cases this system has been extended to other banks besides national banks. A few commonwealths (Delaware, Georgia, Kansas and North Carolina) pursue this method with regard to all corporate shares in general, and collect the tax from the corporation.[2] In a few others, including Iowa, Kentucky and Vermont, the prohibition of simultaneous taxation of both shareholder and corporation applies only to definite classes of corporations.[3] In Ohio it is true only of domestic corporations. In Massachusetts domestic corporations are taxed and the individual shareholders are exempt as regards all dues except those for school-district and parish purposes.[4]

The decisions of the United States Supreme Court are somewhat conflicting. The earlier cases seem to uphold simultaneous taxation of corporation and of shareholder. In a late case, however, the court asserts that double taxation is never to be presumed; and that, although the commonwealths have an undoubted right to levy such taxes, in the absence of a special statutory provision the presumption is against such an imposition.[5] On this point, accordingly, we find contradiction of theory.

In a cognate matter there is a still greater diversity of practice.

[1] See *supra*, p. 155.

[2] Del. Laws, 13, chap. 393; Ga. Code, sec. 815; Kan. Comp. Laws, chap. 107, sec. 6; N. C. Machinery Act of March 11, 1889, sec. A 6.

[3] In Iowa the prohibition applies only to manufacturing companies, Acts 18th Gen. Assembly, chap. 57, §§ 1, 2; in Kentucky to turnpike, gas, telegraph, telephone, express, street-railway and toll-bridge companies, Revenue Law of 1886, chap. 1223, art. iv., § 8; in Vermont to railroads, Rev. Laws, sec. 270.

[4] Mass. Pub. Stat., chap. xi., sec. 4.

[5] Tennessee *vs.* Whitworth, 117 U. S. 136, 137; also, New Orleans *vs.* Houston, 119 U. S. 265. For the earlier cases, see Van Allen *vs.* Assessors, 3 Wall. 573; The Delaware Railroad Tax Case, 18 Wall. 230; Farrington *vs.* Tennessee, 95 U. S. 686; Sturges *vs.* Carter, 114 U. S. 511.

Some commonwealths, as we have just seen, tax the stockholders on the full value of their shares, irrespective of the question whether the corporation has been taxed or not. In other states, however, only a portion of the value of the shares is taxable. Thus in Louisiana, Minnesota and Nebraska, in the assessment of shares of stock to the holders, a proportionate part of the value of the real and personal corporate property taxed within the state is deducted from each share.[1] In New Hampshire and Tennessee,[2] as formerly in New York in the case of banks,[3] a proportionate part of the real estate actually taxed is deducted from each share. In Rhode Island, a proportionate part of the real estate and machinery is deducted.[4] In Maine, a proportionate part of the machinery, goods manufactured or unmanufactured, and real estate locally taxable is deducted.[5] Finally, in New York, the statute (which applies, however, only to state and national banks) provides for the deduction of the assessed value of the real estate. In all these cases only the property actually taxable within the state is deducted. In Vermont, on the other hand, in the case of manufacturing companies the value of the corporate realty and personalty, and in the case of all other corporations the value of the realty, is deducted whether the property be located or taxable within or without the commonwealth.[6] And in the revised franchise tax on business corporations in Massachusetts the value of the taxable property both within and without the state is deducted.[7]

A somewhat analogous question is that of the taxation of the shares of foreign corporations in the hands of individual residents. All those states which, as we have seen, declare it to be justifiable to tax both corporation and shareholder, of course do not hesitate to tax the shares held by residents,

[1] La. Acts of 1888, no. 85, sec. 27; Minn. Gen. Stat., chap. xi.; Neb. Act of March 1, 1879, sec. 32.

[2] N. H. Gen. Stat., chaps. 53–55; Tenn. Laws, 1868–69, chap. 9, sec. 9.

[3] N. Y. Laws of 1866, chap. 761; Laws of 1882, chap. 409, § 312. *Cf.* People *vs.* Commissioners of Taxes, 69 N. Y. 91. These New York laws were repealed when the special 1% bank tax was imposed in 1901. *Cf. supra*, p. 157.

[4] R. I. Pub. Stat., chap. 43, sec. 12.

[5] Me. Rev. Stat., tit. i., sec. 14, § 3.

[6] Vt. Rev. Laws, tit. 9, chap. 22, sec. 288. *Cf.* on this point, Moore, "Corporate Taxation," in *American Law Review* for 1884, p. 771. Moore's statements are not entirely accurate.

[7] *Cf. supra*, p. 206.

even though the foreign corporation itself be taxed. There is here, therefore, no discrimination between domestic and foreign corporations. The other states which declare the simultaneous taxation of corporation and shareholder to be duplicate taxation, may be divided into two classes. Some of them exempt the shares held by residents in foreign corporations, but only when the foreign corporations themselves are actually taxed by the state of their residence. This is the rule in almost all of New England and in a few other states, like California, Louisiana and New Jersey.[1] New York goes still further, and always presumes that the foreign corporation has been taxed by the state of its residence.[2] In actual practice the custom is very much the same in the other states mentioned.

Some states, however, like Massachusetts, make a distinction between foreign and domestic corporations, exempting the shareholders of domestic corporations (or taxing them only through a simple tax on the corporation itself), but assessing the shareholders of foreign corporations on their shares. This practice has given to considerable controversy;[3] but from the standpoint of justice in taxation it can be defended only to a very limited extent. According to the principle of relative economic interests, the shareholder of a foreign corporation is indeed under a certain obligation to support the state of his residence. The proper way to satisfy the conflicting claims is, however, to have the foreign state, which taxes the corporation, divide the tax according to some agreement with the state where the stockholder resides. To tax the shareholder when the foreign state already taxes the corporation seems inadmissible; while entirely to exempt the shareholder is unfair to the state of his residence. Some *modus vivendi* ought to be arranged; but so long as it does not exist, the New York rule should be followed.

[1] N. H. Gen. Laws 1878, chap. 53, sec. 6; Vt. Rev. Stat., tit. ix., chap. 12, sec. 270; R. I. Pub. Stat., chap. 42, sec. 10; N. J. Revis. 1877, p. 115; sec. 64. *Cf.* Smith *vs.* Ramsey, 25 Vroom, 546 (1893); Lockwood *vs.* Weston, 61 Ct. 211 (1891); City of San Francisco *v.* Mackey, 22 Fed. Rep. 602.

[2] *Cf.* Hoyt *vs.* Commissioners, 23 N. Y. 224 (1861).

[3] This has been the law since 1836. But up to 1866 taxes paid on Massachusetts real estate and machinery by the foreign corporation were deducted from the tax on the shareholder. Mass. Rev. of 1836, chap. 7, secs. 2, 4; Dwight *vs.* Boston, 12 Allen, 316. *Cf.* Crocker, *The Injustice and Inexpediency of Double Taxation*, 1892; R. H. Dana, *Double Taxation Unjust and Inexpedient*, 1892. The rule is the same in Md. See Code of Public General Laws (1904), art. 81, sec. 156.

Such is the situation in regard to shares of stock. The same question can, of course, arise in reference to mortgage bonds. As regards the simultaneous taxation of corporate property and the individual bondholder, the disagreement is less profound only because corporate loans are, as we know, rarely taxed. In the one commonwealth, Connecticut, where certain corporations pay what has been pronounced a property tax on the value of their stocks and bonds, it has been held not to be double taxation to assess the individual bondholder as well as the corporation.[1] Yet Pennsylvania comes to the opposite conclusion, so far as the bonds in this commonwealth are taxable only to the corporation and not to the individual bondholder;[2] for in these states neither stockholder nor bondholder is liable. The federal Supreme Court virtually accepts the same principle in deciding that a tax on the bonds is a tax on the bondholder,[3] the corporation being used merely as a convenient means of collecting the tax. It may be confidently asserted, therefore, that so soon as the taxation of corporate loans becomes as general as is now the taxation of corporate stock, we shall be confronted by precisely the same difficulties.

If we turn to Europe, we shall find a still greater diversity of practice. Of the European countries, Switzerland is the only one in which some of the cantons still tax corporate property or capital stock; and in Switzerland the condition is just as chaotic as with us.[4] Thus one set of cantons (Glarus, Grisons, Baselstadt, Aargau and Ticino) formerly taxed only the shareholder.[5] The intercantonal complications, however, soon assumed important proportions; for it frequently occurred that the great majority of the shareholders resided in a different canton from the home of the corporation, to the manifest detriment of the public revenue in the latter. Owing to this fact,

[1] Bridgeport *vs.* Bishop, 33 Conn. 187.

[2] Pa. law of June 30, 1885, § 4. Before the corporation-tax law of 1880, the same principle applied to all corporations in New York. Before the law of 1896 this principle applied also in Maryland.

[3] State Tax on Foreign-held Bonds, 15 Wall. 300.

[4] *Cf.* in general, Schanz, *Die Steuern der Schweiz*, i., pp. 90–99; and Zürcher, *Kritische Darstellung betreffend das Verbot der Doppelbesteuerung*, pp. 36–41. *Cf.* the caution on page 260, *supra*.

[5] This was true in Grisons from 1871 to 1881; in Baselstadt up to 1879; in Aargau to 1885; in Ticino to 1890. See the respective laws in Schanz, *op. cit.*, iii., p. 247; ii., p. 40; v., p. 4, § 20; iv., p. 281. For Glarus, see *ibid.*, v., p. 175.

the above system has now been abandoned by all the cantons except Glarus.

A second set of cantons, which tax the corporate property and income, deduct the shares, dividends or interest in the hands of the security holders of domestic corporations from this taxable property or income. Such is the law in Schaffhausen, Bern, Vaud, Aargau and Uri,[1] and is the practice in Baselstadt, Schwyz and Zug.[2] The security holders of foreign corporations are, however, not exempted from taxation. Grisons, moreover, has the curious provision that while corporations are taxed directly, only the shareholders of domestic corporations are exempt, the bondholders of both domestic and foreign corporations being taxable equally with the corporation.[3] In some of the above cantons, as in Uri, Bern and Aargau, the security holders are exempt only from commonwealth taxes, but are liable for local burdens.[4] It is the same system, it will be observed, as in Massachusetts.

A third set of cantons do not shrink from double taxation, but tax both corporation and shareholder. Such is the law in Baselstadt and Neuchâtel.[5] On this point the decisions of the Federal Council are contradictory.[6] Finally, a fourth set—and this seems the growing tendency in Switzerland—seek to divide the tax between corporation and shareholder. Thus

[1] Schaffhausen, Steuergesetz vom 29 Sept. 1879, arts. 9 and 10, in Schanz, v., p. 259; ii., p. 169; Bern, Vollziehungsordnung, vom 22 März, 1878, § 3, in Schanz, v., p. 83; Vaud, loi d'impôt sur la fortune mobilière du 21 août, 1862, art. 6, in Zürcher, *op. cit.*, p. 38, *cf.* Schanz, iv., p. 158 (true only to 1886); Aargau, Grossrätliche Verordnung über den Bezug der direkten Staats- und Gemeindesteuer, vom 26 November, 1885, § 7, in Schanz, v., p. 15; Uri, Steuergesetz vom 10 Mai, 1886, art. 5, in Schanz, v. p., 375.

[2] For these cantons, see the judicial decisions in Zürcher, *op. cit.*, p. 38.

[3] Graubünden, Steuergesetz vom 28 August, 1881, § 16; in Schanz, v., p. 192.

[4] See the respective provisions in Schanz, v., p. 375, art. 5; 88, § 7; 15, § 7; and 19, § 18.

[5] Bern, Gesetz betreffend die direkten Steuern, vom 31 Mai, 1880, §§ 1, 8; and Gesetz betreffend die Besteuerung der anonymen Erwerbsgesellschaften, vom 14 Oct., 1889, § 1; in Schanz, v., pp. 41, 43, 49; Neuchâtel, Loi sur l'impôt direct du 18 Oct., 1878, art. 5 and art. 6, § 3; in Schanz, v., pp. 218, 219. Schanz, i., p. 95, also includes Zug in this class, but erroneously, as appears from the official decision quoted in Zürcher, *op. cit.*, p. 38.

[6] See the several cases in Schreiber, *Verbot der Doppelbesteuerung*, pp. 199-202. He opposes double taxation. On the other hand, see Meili, "Rechtsgutachten über die Besteuerung der Aktiengesellschaften," in the *Zeitschrift für schweizerische Gesetzgebung*, v., p. 489. See also Zürcher, *op. cit.*, p. 40.

Geneva taxes the corporation on its realty and the shareholder on his shares; but does not permit the shareholder to make a proportionate reduction for the corporate realty already taxed, as is the case in New York, New Hampshire and Tennessee.[1] Appenzell taxes the shareholders on the market value of their shares, but the corporations only on their reserve funds.[2] In Zürich, the shareholders are taxed on their shares; the corporations on their reserve fund and their income in excess of five per cent of the capital. The income below five per cent is not taxed because it is supposed to be hit by the tax on the shareholders. For purposes of local taxation, however, the shareholders are assessed on their shares, but the corporations pay only on their realty and on a proportionate part of their reserve funds.[3]

The 1885 "draft of a federal law on double taxation" sought to divide the tax between corporation and shareholder in a new way. The stockholder was to be assessed by the place of his domicile on the market value of his shares up to the amount actually paid or on the dividends up to five per cent; while the corporation was to pay only on the value of the capital or dividends above this figure.[4] Although this particular draft failed of adoption because of the jealousy of the individual cantons at the supposed infringement of their state rights, the principle has nevertheless been accepted by a single commonwealth,—Vaud. In this canton all shares which stand above par and all bonds which pay more than four per cent interest are assessable to the individual owners at their par value. The corporations are assessed only on the surplus above the capital stock, *i.e.* the reserve and sinking funds and other sums earned during the year.[5] Such a clumsy method is not likely to be

[1] Genève, Loi générale sur les contributions publiques, du 9 novembre, 1887, arts. 300, 324; in Schanz, v., pp. 151, 155.

[2] Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 1880), arts. 5, 6. Schanz, v., p. 26.

[3] Gesetz betreffend die Vermögens-, Einkommen- und Aktivbürgersteuer vom 24 April, 1870, §§ 2, 4; Anleitung betr. das bei der Selbsttaxation . . . zu beobachtende Verfahren, § 6; Gesetz betreffend das Gemeindewesen, § 137, d, e. Schanz, v., pp. 423, 424, 431, 439; ii., p. 435. *Cf.* Zürcher, *op. cit.*, p. 39.

[4] Bundesgesetzentwurf vom 6 März, 1885. In Schanz, i., p. 96.

[5] "Les actions et parts de sociétés qui ont leur siège en Suisse et dont le cours à la bourse est supérieur à leur valeur nominale ou qui rapportent un intérêt supérieur au 4 per cent de cette valeur, sont comptées dans la for-

adopted in this country. On the other hand, in St. Gallen the stockholder is taxed on his shares, the corporation on its income in excess of four per cent interest on the capital.[1] We see, then, that Switzerland has no settled practice.

In the other important European countries the prevailing system as we have learned is that of the taxation of incomes. The same questions arise as to the taxation of corporate profits and of shareholders' or bondholders' income.

In England, the income tax payable on annual profits or gains according to schedule D of the income tax is advanced by the corporation, and is deducted by it from the dividends or interest due the security holders, who are then to that extent exempt from the income tax.[2] In Austria the facts are similar to those in England.[3] In Italy, the law requires the income tax to be paid by the corporation, but does not interfere with the adjustment of the tax between the company and the shareholders. Nothing would prevent the corporation from deducting the tax from the dividends; but in fact, it is the custom for the corporation to charge the tax to expense account, with the same result for the shareholder. The latter is not assessable on his dividends because the law expressly forbids double taxation of this kind.[4] As regards bondholders the companies are required to pay the tax on coupons, with a right to recoup from the bondholders.[5] The companies generally do not de-

tune mobilière du porteur ou des créanciers pour leur valeur nominale seulement. . . . L'avoir net (réserves et amortissements compris) des sociétés . . . est compté dans la fortune mobilière de ces sociétés pour tout ce qui excède le capital social." Loi d'impôt sur la fortune mobilière, *etc.*, du 21 août, 1886, art. 11. Schanz, v., p. 387; iv., p. 158.

[1] Gesetz über die Einkommensteuer, sowie über die Besteuerung der anonymen Gesellschaften (1863), art. 5; Verordnumg über Besteuerung der anonymen Gesellschaften vom 28 Jan., 1867, arts. 4, 11. Schanz, v., pp. 309, 311.

[2] Ellis, A *Guide to the Income Tax Acts*, pp. 78-112.

[3] Wagner, "Direkte Steuern," § 103, in Schönberg, *Handbuch der politischen Oekonomie*, iii., p. 307. Wagner's discussion of these points is not adequate or conclusive.

[4] "Ne saranno soltanti eccettuati [in the taxable income] i redditi che per disposizione della presente legge siano già una volta assoggettati all' imposta in essa stabilita." Legge per l' imposta sui redditi di ricchezza mobile, art. 8, § 2.

[5] " . . . Le società anonime dichiareranno non solo i redditi propri, ma eziando . . . gli interessi dei debiti da loro contratti e delle obbligazioni da loro emesse, e pagheranno direttamente l' imposta relativa anche a questi ultimi redditi, rivalendosene sui loro assegnatori e creditori mediante ritenuta." *Ibid.*, art. 15.

duct anything from the coupons, but, as with dividends, charge the tax to expense account. In this case it would seem as if the stockholders were liable for the tax, since, strictly speaking, it would have to come ultimately out of the stockholders' dividends, and not out of the bondholders' interest, which is legally fixed. In actual practice, however, this distinction is not observed. The bondholders, moreover, are not assessable if the corporation has paid the tax. In France, the tax *sur le revenu des valeurs mobilières*, so far as it applies to the dividends or interest of corporate securities, may be primarily collected from the company and then deducted by it from the sums due the security holders, as in England; or the tax may be assumed directly by the companies,[1] as in Italy.

In Germany, every possible plan has been tried, without reaching any definite or uniform conclusions. The matter is, moreover, further complicated by the fact that corporations like individuals must pay a business tax (*Gewerbesteuer*), somewhat akin to licenses or occupation taxes in the Southern states of the American Union. In a number of German states (Oldenburg, Brunswick, Gotha, Schaumburg-Lippe, Waldeck and Lübeck) the corporations pay no income tax, but the shareholders and bondholders are taxed.[2] In other states, like Saxe-Weimar, Lippe-Detmold, Bremen and Hesse, the corporations are assessed, but the shareholders and bondholders are exempt.[3] Even in these commonwealths, however, the definitions of corporate net income do not tally. In most of the remaining states, like Prussia, Saxony, Baden, Bavaria, Würtemberg,

[1] Tanquérey, *Traité . . . de l'impôt sur le revenu des valeurs mobilières*, pp. 143–150; Vignes, *Traité des impôts en France*, i., pp. 405–409; Kauffmann, *Die Finanzen Frankreichs*, pp. 288, 291.

[2] *Cf.* the details in Antoni, "Die Steuersubjecte im Zusammenhalte mit der Durchführung der Allgemeinheit der Besteuerung nach den in Deutschland geltenden Staatssteuergesetzen," in *Finanz-Archiv*, v., pp. 916–1033, especially 1010. The statements in this paragraph are true of the situation in 1895. For later changes see the work of Blum, cited *supra*, p. 262, note 3.

[3] Sachsen-Weimar, Gesetz über die allgemeine Einkommensteuer, von 19 März, 1869 [with amendments of 1874, 1877 and 1880], §§ 48 and 4. Printed in *Finanz-Archiv*, ii., p. 932.—Lippe-Detmold, Gesetz die Klassen- und klassifizierte Einkommensteuer betreffend, von 1868 [with amendments of 1882 and 1885], §§ 1, 7.—Bremen, Einkommensteuergesetz von 17 Dez., 1874, § 5.—Hessen, Gesetz von 1884, die Einführung der Einkommensteuer betreffend, arts. 4, 19. In *Finanz-Archiv*, ii., pp. 383–434. For Hesse in particular, see Schanz, "Die direkten Steuern Hessens und deren neueste Reform," *Finanz-Archiv*, ii., pp. 235–529. Also Conrad's *Jahrbücher*, xii., p. 40.

Mecklenburg, Anhalt and the other minor commonwealths, both corporation and security holder are taxed—the corporation on its income or business, the individual on his income from the corporate security.[1] In one case (Baden) the same income was until recently taxed four times—that is, the corporation paid a business tax (*Gewerbesteuer*) and an income tax, while the individual shareholder or bondholder paid not only an income tax but also a tax on the interest of his capital invested in the bonds or stock (*Kapitalrentensteuer*).[2] In the original draft of the bill to reform the Prussian law, this same quadruple taxation was proposed;[3] but its injustice was so manifest that the project failed. It was also proposed in Hesse, but without success. In 1906 the supplemental property tax took the place of the business tax and of the capital tax in Baden, but as both corporations and individuals are subject to this property tax, the quadruple system virtually continues.[4] Baden, therefore, was the only state in the world which could pride itself upon assessing the same subject four times.

We see, thus, that in Europe there is no settled practice at all, although the tendency seems to be to tax the corporation and to exempt the individual on his income from corporate investments. Is this the correct policy? Is it true that in taxing the corporation, whether on property or on income, we are taxing the individual holder of the shares or bonds?

This brings us to the pith of the question. What is the incidence of the corporation tax? Where does the burden really fall? This question has never yet received adequate attention.[5]

[1] Sachsen, Einkommensteuergesetz von 1878, § 4.—Bayern, Einkommensteuergesetz von 1881, art. 1, § 15. In Seisser, *Die Gesetze über die direkten Steuern im Kgr. Bayern*, i., 158.—Württemberg, Gesetz von 1872, art. 1, § 3. In *Sammlung württembergischer Steuergesetze* (1883).—Mecklenburg, revidiertes Contributionsedict von 1874, §§ 13, 45.—Baden, Gesetz von 1884, die Einführung einer allgemeinen Einkommensteuer betreffend, art. 5. In *Finanz-Archiv*, ii., pp. 361–394. *Cf.* Philippsberg, *Gesetz über die direkten Steuern in Baden* (1888).—Anhalt, Gesetze von 1886, die Einführung einer Einkommensteuer . . . betreffend, §§ 2, 4. *Cf.* Schanz, "Die Steuern im Herzogthum Anhalt, ihre Entwickelung und neueste Reform," *Finanz-Archiv*, iv., pp. 961–1070, especially 1016. For Prussia, see Einkommensteuergesetz von 1891, §§ 12 b, 14.

[2] *Finanz-Archiv*, ii., p. 320. *Cf.* Lewald, "Die direkten Steuern in Baden," in *Finanz-Archiv*, iii., p. 350.

[3] Einkommensteuergesetzentwurf von 1883.

[4] *Cf.* Blum, *op. cit.*, pp. 52–56.

[5] The nearest approach to a discussion of this question is to be found in Helferich, "Ueber die Einführung einer Kapitalsteuer in Baden," in Tü-

VI. *Incidence of the Tax*

It is generally assumed that a tax on a corporation is a tax on the shareholder or bondholder. But as has already been pointed out,[1] a distinction must be drawn between the original holder and the recent purchaser of corporate securities. Under certain circumstances the burden of a tax is not borne by the purchaser of new corporate securities, but falls entirely on the original holder of the old securities issued before the tax was imposed. If a corporation is taxed on its income, and if no similar tax is levied on other corporations or on other securities, the stock will fall in value and the new purchaser who buys at the reduced price really buys free of tax. Although he pays the tax, the amount of the tax is thus discounted in the depreciation of the security. With the lapse of time and the fluctuations in the market the original holders all disappear. Hence at any given time an exclusive income tax levied only on the corporation and not on the shareholder does not affect anyone except the original holders who bought before the imposition of the tax. It is only a question of time until this class of original holders disappears entirely.

As to bondholders, the argument is precisely the same if the corporation is empowered to deduct the tax from the interest. The lower rate of interest is discounted in the depreciation of the bond, so that the new purchaser loses nothing. Moreover, in those cases where, as we have seen, the tax is borne by the corporation and not deducted from the interest,[2] the bondholder does not suffer at all, except in so far as it somewhat lessens the security of the mortgage.

Of course this is more or less true of all new taxes under certain conditions. By virtue of what is called the capitalization of taxation a new tax may affect the original owner of the

binger *Zeitschrift für die gesammte Staatswissenschaft*, 1846, pp. 291-324, especially 315 *et seq.*

[1] *Supra*, p. 108.

[2] During the Civil War, when a federal tax was imposed on the coupons and dividends of certain corporations, many corporations declared these "free of tax," and refused to withhold the amount from the sums due to the bondholders and stockholders. They simply assumed the tax and charged it to expense account, asserting that while the law authorized, it did not direct, them to withhold the tax. See *Internal Revenue Record*, vol. i. (1865), p. 153.—The practice was thus the same as in Italy to-day.

taxable article more than the new purchaser. In the case of direct taxes the original holder may be injured while the future purchaser may discount the tax in the depreciation of the article. In the case of indirect taxes the reverse is true, for the effect of the tax often is to increase the price. The lucky owner who holds the commodity before the imposition of the tax then reaps the benefit of the rise in price. The point which is usually overlooked, however, is the question whether the new tax is general or partial. If the direct tax applies to all subjects in the class and to all classes, then the new purchaser is taxed equally with the original owner. For if the tax is general there will be no depreciation in value. It is only when the tax is partial, assessing some articles in the class more than others, that it may under certain conditions be capitalized, and that a decrease in the value of the overtaxed article may ensue.

If we apply this principle to the corporation tax, we reach the following results: If the corporation tax simply forms a part of a general scheme of income taxation, as in England or in Italy, the shareholder must indeed be exempted. Since the tax affects the interest on all investments, not simply on corporate securities, the investor, whose interest was cut down, will not find any non-taxable securities of equal desirability from which he can obtain the original rate of interest. In such a case, therefore, the tax on the corporation is a tax on the investor. To tax both corporation and individuals on their income would really be double taxation. On the other hand, if the corporation tax is partial—*i. e.* if only corporate, and not other, securities are taxed, or if only a few classes of corporations are taxed—then the taxation of the corporation is not sufficient to reach the purchaser. He will practically escape, because the freedom of investing in non-taxable securities will enable him to discount the tax in the price he pays. If a general income tax is imposed, it will not be valid for the new purchaser of corporate securities to claim exemption on the ground that a tax has already been imposed on his particular corporation. To tax both the corporation by a special corporation tax and the shareholder by a general income tax in such a case is not unjust or double taxation. To tax the corporation alone would in reality not burden the shareholder who purchased after the tax was imposed. An additional tax on the new shareholder in common with all other recipients of income would thus really constitute no injustice to him. The practical difficulty of course

would consist in distinguishing between the old and the new owners.

Thus far we have been discussing the incidence of the corporation tax in a scheme of income taxation. How does the matter stand in the case of a property tax?

The principle is the same. Let us assume that in addition to the corporation tax a general property tax is actually levied on all individuals. The corporation would then pay the first tax, and the individuals would pay the second tax upon corporate shares and bonds. This would indeed be duplicate taxation, but only on the assumption that the corporation tax is imposed on all corporations in general, and that the property tax is actually assessed on all kinds of property. In such a case it would be unjust to tax both corporation and shareholders. This is the assumption made by most of the American commonwealths, which, as we have seen, generally exempt the shares when the corporate property or franchise is taxed.

The assumption, however, is not always correct. In the first place, only special classes of corporations are sometimes taxed. Secondly, the general property tax we know to be general only in name, for by far the larger part of personal property or of investments in the hands of individuals escapes taxation. Under these conditions the matter may be entirely different. If the tax be imposed on only a particular class of corporations, and if the conditions are not such as to bring about a shifting of the tax to the consumer of the commodities produced, the corporation tax will, if all other securities escape assessment, be discounted in the lower market value of the shares, because, other things being equal, the value of new investments will vary in proportion to the net profits to be derived therefrom. Although the corporate tax reduces the dividends, the reduced dividends on the reduced value will yield to new investors as large a percentage as did the larger dividends on a property of greater value—greater because untaxed. Thus where there is only a partial tax of this kind on personal property a special corporation tax puts the new purchaser of shares in the same position as if he owned non-taxable property, *i. e.* it virtually imposes no additional burden on any of the shareholders except the original owners. In the case of bondholders where the corporation tax is deducted from the interest, this is equally true. When the corporation tax is assumed by the

corporation and not deducted from the interest—the almost universal rule in the United States—the bondholders are not reached at all, except in the very indirect way that they may be exposed to an ultimate diminution in the security of their lien. The tax as such does not strike them; their property, consisting of corporate bonds, goes scot-free. A property tax or franchise tax on the special corporation, under the given conditions, is really not an additional burden on the individual holder of corporate securities or at all events not on all the individual security holders.

The practical conclusion applicable to the United States to-day is as follows:

If the corporation tax is to be utilized as a means of reaching the faculty of the security holder, rather than of the fictitious person known as the corporation, it is necessary to generalize the tax—to levy a general tax on corporations, as a few states are now beginning to do. Furthermore, the corporation tax must be regarded simply as a part of a larger system of taxation, the constituent elements of which must endeavor to reach the other sources of the taxpayer's ability. The corporation tax, in other words, must be supplemented by other taxes, both state and local, in order that these taxes combined may stand in some proportion to the revenue of the individual. Then, but only then, will it always be double taxation to assess the corporation as well as the security holder. So far as there is a decided tendency to generalize the corporation tax, the trend of American legislation, in seeking to avoid double taxation, is in the right direction.

VII. *Local Taxation*

Up to this point we have discussed chiefly the state taxation of corporations. But the lesser governmental divisions also have their claims to urge, especially in modern times when local needs outweigh so heavily those of the states. There are no less than five different methods of taxing corporations for local purposes in the United States. These are as follows:

1. A local general property tax.
2. A local corporate franchise tax in addition to the general property tax.
3. A local tax on real estate.
4. No local tax at all.

5. A distribution of the state tax on corporations to local districts.

The first plan, that of the local property tax, is still usual, even in some of the commonwealths that have abandoned the general property tax on corporations for state purposes. Corporate property is in some cases measured by the capital stock. In New York, for example, while banks, insurance and telegraph companies are taxed according to special laws, in the case of other domestic corporations the tax is levied at the usual rate of the local tax on the actual value of the capital stock, together with the surplus profits or reserve funds exceeding ten per cent of the capital, after deducting the assessed value of the real estate and of the shares of stock in other taxable corporations.[1] Foreign corporations, however, are taxable only on the sums actually invested in the state.

The second method, that of a corporate franchise tax in addition to the local property tax, is found in Kentucky, where the tax on the franchises of certain corporations may be levied also by the local divisions. Somewhat analogous to this are the local licenses which in many of the Southern states are imposed on corporations as well as on individuals in addition to the state licenses.

The third method, that of a local tax on real estate only, is becoming more and more common, especially in the commonwealths which impose a separate state tax on certain kinds of corporations, like transportation and insurance companies. It is likewise the custom with banks, which pay a local real estate tax, and also advance the tax on shares assessed to the shareholders.

The fourth plan, the exemption from local taxation, is found in a few states which impose a franchise tax on certain classes of corporations. The only state which has a general corporation tax law in lieu of local taxation is Pennsylvania. Even there certain classes, like purely manufacturing companies, which are excepted from the operation of the general corporation tax, are subject to local taxation on their real estate. Furthermore the real estate of railroad and other transportation and transmission companies, not necessary to the exercise of their franchise, may be taxed by the local bodies. Some cities are also permitted by their charters to tax the real estate of certain corporations, and the courts have ruled that the general cor-

[1] Laws of 1857, chap. 456, vol. ii., p. i.

poration tax law does not deprive these municipalities of the right to tax their real estate.[1] Finally, the tax on banks and insurance companies, being in some cases practically a tax on incomes, does not exempt their real estate entirely from taxation. Practically, therefore, in Pennsylvania, as by statute in California, the exemption from local taxation applies only to public-service corporations.

The fifth and last method of local taxation, the distribution of the state corporation tax to local bodies, is found in the case of railroads in several states like Maine, Mississippi, West Virginia and in the case of corporations in general in Massachusetts. But in some of these states the local bodies levy additional taxes, as in Massachusetts on real estate and machinery.

Of all these systems the third is clearly the best. All corporations with the possible exception of those enjoying special municipal franchises should be made to pay a local tax on their real estate; first, because it is mainly the realty which comes into direct relations with the purely local functions; and secondly, because the attempt to tax personalty would immediately lead again to the uncertainty and confusion from which it has been the policy of all recent reforms to extricate us. But in the case of public-service corporations, with contiguous pieces of real estate in many localities, experience has shown the advisability of central assessment, with a unit rule, even if the proceeds of the real estate tax accrue in a fixed ratio to the localities.

The New York system, therefore, is triply unwise: first, because it imposes a state tax on corporate real estate; secondly, because it further imposes a local tax on the total corporate property; and thirdly, because the real estate of public-service, like other, corporations is separately assessed at ridiculously varying sums, by the local officials. The former Minnesota or the Connecticut system, as applied to railroads, is unwise because it imposes no local tax at all. The system as formerly practiced in Washington was unwise because it imposed only a single state tax which was in part redistributed to the local divisions. All these methods err because they fail to analyze the deeper principles that underlie corporate taxation.

The plan of levying a general state tax and distributing a part of the proceeds to the counties or municipalities contains a fruitful idea. It is already in vogue in an incomplete

[1] Pennsylvania R. R. Co. *vs.* Pittsburgh, 104 Pa. State, 522 (1883).

way in a few commonwealths, as we have seen. But it is susceptible of great expansion and may be of considerable value in solving the vexed question of local taxation. If the commonwealth treasury should be supplied through other sources, such as a state inheritance tax or a state income tax or a state tax on other elements, it would be possible not only to abandon the state taxation of real estate, but also to relinquish to the local bodies a portion of the state corporation taxes. The logical plan for the immediate future, however, is to tax corporations on their receipts, or on a valuation equal to the stock and bonds, for state purposes; and to tax them on their real property for local purposes, with the understanding that in the case of public-service corporations this local real-estate tax should be subject to central assessment in accordance with the unit rule. The question of the division of the yield of the corporation tax may safely be left to a consideration of the particular needs in each individual case, after the principle has first been applied to the other state-wide taxes.

VIII. *Conclusion*

From the preceding survey it appears that the United States are slowly advancing to a more rational and harmonious system. The tendency of legislation and of judicial interpretation in the most progressive states is toward the following plan, which, although not yet completely realized in all its features in any one state, is in accord with sound economic principles:

1. Corporations should be taxed separately and on different principles from individuals.
2. Corporations should be taxed locally on their real estate only.
3. Corporations should be taxed for state purposes on their earnings, or on their capital and loans.
4. Only so much of total earnings or capital should be taxed as is actually received or employed within the state. In the case of transportation companies, a convenient and fairly accurate test is mileage.
5. Where capital and loans are taxed, the residence of the shareholder or bondholder should be immaterial.
6. There should be no distinction between domestic and foreign corporations. Each should be taxed for its business done or capital employed within the state.

7. If corporations are taxed on their property, property beyond the state should be exempt.

8. If corporations are taxed on their capital stock, they should not be taxed again on their property.

9. Where the corporate stock or property is taxed, the shareholder should be exempt. If corporate loans are taxed, the bondholder should be exempt.

10. Where the corporation and the shareholder or bondholder are residents of different states, the tax should be divided between the states by interstate agreements.

11. An additional tax or a higher rate should be imposed on corporations which have through natural, legal or economic forces become monopolistic enterprises.

CHAPTER IX

MODERN PROBLEMS IN TAXATION [1]

In attempting to present a survey of the modern practical problems in taxation we are naturally confronted by the difficulty that the actual problems assume a different aspect in various countries, an aspect largely colored by fluctuating political, economic, and social conditions. Notwithstanding this diversity, however, there can be discerned an underlying uniformity in the modern fiscal development of civilized nations, and it will be our endeavor to point out some of the different phases of this development.

There are several considerations which distinguish the modern science of finance in the study of tax problems. These are, in order: the pursuit of justice, the emphasis put upon modern economic phenomena, and the insistence upon conformity with economic principle. Let us consider each of these in turn.

I. *Justice and the new Economic Basis of Society*

The first point is well summed up in the alleged conflict between the fiscal and the social principles of finance. We say alleged conflict, because in reality there is, from a deeper point of view, no such conflict at all. It is sometimes asserted that the fiscal object of taxation is simply to secure revenue, while the social object is to effect some desirable change in social relations. This antithesis rests upon a failure to observe that finance, like economics, is a social science, and that even from the narrow political point of view of the relation between the government and the citizen, the government cannot derive any revenue—that is, cannot take any part of the social income—without inevitably affecting social relations. The fact that the government has in mind solely the fiscal aim of securing revenue does not alter the social consequences of the particular revenue

[1] This chapter first appeared, in slightly different form, and under the title "Pending Problems in Public Finance," in *Proceedings of the Congress of Arts and Sciences, Universal Exposition, St. Louis, 1904*, vol. vii.

system. In modern times social conditions are influenced to a large extent by changes in wealth. Every tax necessarily affects the wealth of individuals, and if we could in all cases trace the final consequences of even a "purely fiscal" tax, all kinds of unforeseen results, social as well as fiscal, or perhaps better, social because fiscal, would disclose themselves. Economics and finance deal not with intentions, but with results. The function of fiscal science is to point out to the legislator the necessary results of his actions.

The distinguishing mark of modern social science is that it endeavors to explain not only what is, but also what should be. All practical action is thus brought to the crucible of justice, and all systems of taxation are put to the test of conformity with this principle, irrespective of the intentions of the legislature. The great problem which still remains, however, is to elucidate the exact nature of this economic justice. Every one agrees that the essential ingredients of this scheme are equality, or uniformity, and universality of taxation. When, however, an attempt is made to interpret them and to outline the practical form which these principles should take, there is considerable disagreement, because the actual nature of the principles has not been thoroughly analyzed. It betokens, however, a step forward in all practical finance that a more or less conscious effort is everywhere being made to bring the tax system into some manner of conformity with the principle, however dim its outlines may be.

The second point, which differentiates modern taxation from that of the past, is the emergence of the new economic substratum of society. These new facts of fiscal importance may be summed up under the following heads:

First, the increasing economic significance of the laboring class, with the corresponding growth in the importance of popular consumption. It is not meant by this to imply any depreciation of the rôle played by capital. On the contrary, it is a platitude to say that this is pre-eminently the capitalistic age. What it is intended to emphasize is that precisely because of the growth of modern economic well-being, the great mass of the community, represented by the laborers, are acquiring an increased consuming capacity and that their demand is the very tap-root of modern progress. The recognition of this fact has brought about vast changes in modern tax systems.

In the second place we have to note the coming to the fore of the corporation as the typical form of modern business enterprise. The evolution from the individual to the early partnership, from the partnership to the joint-stock company, from the joint-stock company to the corporation, and from the corporation to the trust is one of the most instructive lessons in institutional development. Finance has not to study it, but to accept it. Tax systems framed upon the assumptions of the older conditions, where corporate activity was the exception rather than the rule, are manifestly inadequate and belated.

The third change consists in the growing importance of the problem of franchises. This is not the same as the corporate problem, although often confused with it. A franchise may assume many forms. It may be a patent or copyright in the hands of an individual; it may be the privilege of inheriting property, whether that privilege be granted to a single person or a group; it may be a right accorded to corporations to utilize opportunities which originally belonged to the community, and which are for sufficient reasons given away. Such privileges and franchises have indeed existed from of old, but the complexity of modern society and the immense increase of public wealth have vastly enhanced both their extent and their significance. How to analyze them, how to measure them, and how to fit the result into the system of public revenue is becoming one of the most subtle and difficult problems, which will, no doubt, long perplex the trained student as well as the legislator.

The fourth change is the economic revolution affecting the distribution of governmental authority as between the general and the local government. The cause of this change, as is well known, is not only the forging to the front of the interests of peace rather than of war, but above all, the agglomeration of modern population into urban centres. With the segregation of wealth and property into great local masses, there is coming the need of administering to the wants of such complex aggregates. Accordingly, while the last century has shown a great increase of national expenditure and income, there has been a far larger growth in local expenditures and incomes. And whereas formerly local taxation could be treated as a relatively unimportant appendage to national taxation, it now claims a distinct and separate place of its own.

Side by side, however, with this localization of wealth there has been a counter-movement in the direction of the nationaliza-

tion of wealth, in the sense of nationalization in the opportunities of securing wealth. The economic activities of to-day have far outgrown the swaddling-clothes of former times. Business enterprise not only covers the whole country, but encircles the globe. Citizenship in the various commonwealths of a federal state, like Germany, Australia, Switzerland, or America, has become in great measure meaningless because its economic basis has been so effectively weakened. In all federal states, therefore, the problem of taxation is complicated by the difficulty of correctly apportioning the burdens among the constituent commonwealths. In every country, federal or not, a similar difficulty exists as between the local government and the state government. Problems of double taxation resting upon interstate and interlocal complications arise to confront us at every turn.

The fifth and final point is that of the modern social solidarity. In former times the close relation subsisting between the various branches of productive enterprise in the community was beclouded by the predominant social and political influence secured by some one factor. In an economy based upon slavery the only importance of a slave is that of a working-tool; in an economy based upon the predominance of the large landowner, the function of the moneyed and commercial interests is apt to be overlooked. In the early stages of the factory system, where the mass of the laborers are regarded from the point of view of production rather than from that of consumption, it is natural that the socialistic conception of class conflict should emerge. A more careful study, however, of modern industrial society has shown that while indeed there is no such thing as a natural harmony of interest, there is a distinct and inevitable influence, sometimes for good, sometimes for evil, exerted by each factor of production upon the other, and by each social class upon its neighbor. Laborers and capitalists, landowners and traders, factory owners and financiers, are pursuing their own interests, and in so doing they necessarily react upon the interests of the others.

The distinguishing mark of modern economic life in this respect is the realization of these close economic interrelations. The machinery of production has become so subtle and so complex that the disarrangement of any one part throws the whole out of gear. The overburdening of any one class may have the most unlooked-for consequences upon another. Taxation, as a

weapon of retaliation, often proves to be a boomerang. An undue pressure on a railroad may decrease facilities, rather than increase revenue. The assessment of mortgages may hit the farmer rather than the money-lender. The taxation of the laborer may limit the market, rather than increase the profits of the capitalist. Whether we desire it or not, modern economic conditions are engendering a situation where every one is in a larger sense his brother's keeper and where at all events it is unsafe to disregard the often hidden and recondite, but none the less active, influence exerted by each economic class upon the others.

All these changes in economic life have affected the practical system of taxation throughout the world. They have created new problems for the scientific student. The justification of finance, however, as a science, rests upon the correlation of fiscal problems with economic principle. We thus come to the next part of the discussion, the influence of economic analysis on fiscal facts.

II. *Economic Analysis and Fiscal Facts*

The first result of economic analysis was to show the errors of a tax system resting exclusively or in great part upon consumption. The theory of consumption as the test of faculty or ability to pay was promulgated in the later middle ages by reformers who despaired of reaching the privileged class in any other way. Every man, it was said, must consume, and the more idle a man is, the more luxuries will he consume. A consumption tax thus seemed to be the sole method of securing universality of taxation. To these considerations there was added the thought, on the part of some, that so far as the working-classes were concerned, taxes on the necessities of life would be admirable, in that they would compel the laborers to work harder.

In opposition to this view, a more careful economic analysis disclosed the fact that a tax on consumption, regarded as a universal system, was unwise and unjust—unwise because a tax on mere luxuries would be most disappointing in the yield; unjust because a tax on necessities would fall with crushing severity on those classes which could least afford to bear the burden. Above all, it was recognized that by checking consumption we were thereby checking production, and that a general tax on consumption would possess most of the disadvantages of a tax on production and few of its advantages.

Consumption taxes, therefore, as a sole or chief reliance of the government, have been fast disappearing. One of the first acts of the American Government in Cuba and the Philippines was to abolish the *consumo* tax; and it is well recognized that the continuance of the municipal *octroi* in France and Italy is deplored by all serious students.

The next triumph of economic theory was to disclose the dangers of a system of taxation resting on production and exchange. In one sense indeed every tax that is not a tax on consumption may be regarded as a tax on production, for all wealth consists either of producers' goods or of consumers' goods. It would, therefore, seem to be impossible to avoid the imposition of taxes on production. In the sense in which the term has usually been employed, however, a tax on production has denoted a tax imposed directly, and at a late stage, on the process of completing the finished article. Regarded in this light, such taxes manifestly impede the process of production and are to be deprecated because they affect the able and the shiftless producer alike. Taxes on production often put a premium on inefficiency and are apt to clog the wheel of industrial progress. The tendency of modern statesmanship has accordingly been away from reliance on such methods.

Perhaps the greatest change in fiscal theory during the nineteenth century has been, thirdly, to analyze and to explain the need of taxing shares in distribution rather than consumption or production. We have learned in a preceding chapter how the principle of faculty or ability to pay has gradually worked itself through the conscience of the public and the theory of the publicist. A vast amount of ingenuity has been expended upon the attempt to disclose the real meaning of faculty as measured by the property or the income of the individual. When we come to consider the facts, however, there are two striking considerations that confront us. The first is the exceedingly small proportion that the income tax bears to the total revenue. In France, for instance, there is as yet no income tax at all, and even in England and Germany the proceeds of the income tax are insignificant when compared to the total revenue, state or local. The scientists may discuss and do discuss the problems of progression and differentiation of taxation, and all of the discussions rest on the assumption that the burdens upon the individual must be in a certain proportion to this income; yet we find as an actual fact that only

a very inconspicuous proportion of the taxes in the civilized countries of to-day stand in any direct relation to the income of the taxpayer.

Not alone do the income taxes form so small a part of the whole, but furthermore, in many countries the so-called income taxes are really not taxes on the personal income of the individual. In England, for example, it is well known the so-called income tax is merely a collection of taxes on the thing which yields the income rather than on the person who receives it. That is, it is a collection of taxes on produce and not on income. The only exception is the famous schedule "D," which is notoriously the least successful of all. It may be claimed indeed that in Prussia the income tax is really what it purports to be, but all who have made a study of the system know that when similar methods were employed in England at the beginning of the nineteenth century, they proved to be a dismal failure. The English administrators consider the principle of their tax far superior to that of the Prussian; and to the extent that this contention is justified, the superiority rests upon the fact that the tax is not one on personal income.[1] Even in Prussia itself, the home of efficient bureaucracy, the tax has been by no means free from objections. The same repugnance to the personal element in the income tax which is found in England explains why it has been impossible as yet to introduce the system into France, with its still lively recollection of the abuses of personal taxation under the *ancien régime*, and explains also why the income tax has been so slow in coming in the United States.

We thus find the remarkable fact that while the science of finance has been elaborating its fundamental principles, it has succeeded in some respects, but has failed in others in imprinting its conclusions upon legislation. It has brought the actual taxes on consumption and production, to a great extent, into line with its conclusions, but it has spent most of its time during the nineteenth century in working out the principles of an income taxation, which is either not accepted in legislation, or which, if accepted, is realized to so small an extent and in such a half-hearted way that it covers at best only a fraction of the field of taxation.

The conclusion is hence forced upon us that the fiscal analysis

[1] *Cf.* as to this point and the remainder of this paragraph, Seligman, *The Income Tax*, 2d ed., 1914, *passim*.

has not proceeded sufficiently far. We are indeed grateful for what has been accomplished, but we have evidently not yet reached the goal. In addition to the theory that the modern development of taxation is to be interpreted in the light of the doctrine of individual ability or faculty, we need a supplementary principle to help us thread our way through the maze of actual fiscal facts.

This principle is that of the social versus the individual basis of taxation. The conception which has dominated fiscal science until lately is the individual conception. Direct taxes have in theory been preferred to indirect taxes, because they were supposed to rest where they were imposed, and thus to help in securing justice as between individuals. The goal of all taxation was the attainment of a method in harmony with individual faculty. The first serious breach in this doctrine was made by the diffusion theory of taxation. The diffusion theory erred, indeed, in that it went too far in attempting to show that every tax is always and inevitably shifted off from the shoulders of the original payer. The value of the diffusion theory, however, consists in the fact that it put the problem in the right way, by presenting the societary aspects of taxation.

Nevertheless, the diffusion theory made the situation too simple. It has quite correctly been termed superficial and one-sided. To make it at all serviceable, it needs to be supplemented by another theory, which I have taken the liberty of calling the absorption theory of taxation.[1] The absorption theory rests upon the doctrine of capitalization. That is to say, where the tax is not shifted from the seller to the buyer and where the economic good has a rental value as well as a capital value, the tax which remains on the taxable object and which, therefore, to that extent diminishes the income to be derived from it, *i.e.*, its rental value, must also proportionally diminish its capital value. The selling or capital value of anything is always the capitalization of the actual and prospective rental or income value. As a consequence, through this familiar principle of capitalization the new purchaser of the commodity will buy it at the reduced price, and will thus virtually buy himself free from taxation. Where the tax cannot be shifted, it will be discounted, or absorbed, in the new and lower price.

A new tax on city real estate, for instance, will either be

[1] *Cf.* Seligman, *The Shifting and Incidence of Taxation*, 4th ed., 1921, pp. 221-226, 390-393.

diffused by increasing the rents of the tenants, or it will be absorbed in the sense that when the property changes hands the new purchaser will pay a price reduced by the capitalization of the tax. So a new tax on corporate securities will either be diffused by increasing the price of the product or it will be absorbed in the new and lower price of the securities.

The combination of the diffusion and the absorption theories of taxation explains several things. It explains why the theoretic distinction between direct and indirect taxes based upon the alleged facts of incidence is erroneous. It explains why in spite of this theory the great mass of revenue to-day continues to be raised in the shape of indirect taxes. It explains why in countries like the United States the state and local taxes, although still in principle levied on persons, are slowly coming to be imposed on things rather than on persons; it explains why in France personal taxes have been impossible since the Revolution; it explains why in England, with the exception of a single schedule of a single tax, the whole system of taxation is based on things and not on persons; it explains why, even in Germany, where the personal and individual elements of the problem have been emphasized in theory, the personal share in actual taxation is so insignificant; it explains, finally why the legal decisions on taxation in the United States are coming to be in harmony with the truer economic doctrine of universality and equality of taxation. For this does not mean that everybody must be taxed alike, but only that all the members of a given class must be taxed alike, while there may be the greatest diversity between classes. An equal tax on all corporations does not imply that each individual stock- or bond-holder who may have bought after the tax was imposed pays equally, just as little as an equal tax upon real estate implies that each individual land- or house-owner everywhere and necessarily bears the burden of the tax.

In short, the individual point of view in taxation, which assumes that justice can be done by assessing each individual directly and in first instance, rests upon an analysis which does not comprehend all the elements in the problem. The social point of view is that of modern economics, which seeks to trace the workings of general economic law and to study the forces which affect the distribution of the social income. The individual point of view while good as far as it goes, is not only inadequate in itself, but fails to explain all the developments of

modern taxation. It must be supplemented by the social point of view, resting upon a combination of the absorption and diffusion theories, and which is in harmony with those facts of fiscal life that are difficult to explain on any other interpretation. It is safe to predict that when once this is accepted, the most fruitful work of the future in the science of finance will consist in the elaboration in detail of the conditions and the limits of the absorption and diffusion theories.

III. *The Practical Problems*

Regarded from this point of view, a new light is thrown on the practical problems throughout the world. The most important of these pressing problems are as follows: First, the reform of so-called indirect taxation. The social consequences of indirect taxation are now recognized to an ever-increasing extent. So far as taxes on consumption are concerned, it is fairly well appreciated that the commodity taxed must possess the mingled qualities of a necessity and a luxury; if it possess only the characteristics of a luxury the revenue will be insignificant; if it possess only the qualities of a necessity, it will fall with undue severity on the modest consumer. If, however, it combines both characteristics, namely, that of wide use and at the same time that of a certain degree of dispensability, the revenue is apt to be large and elastic and the burden not too severe. The number of consumable commodities that unite both these characteristics is small, and hence we find everywhere throughout the civilized world the tendency to restrict taxes on consumption to very few, but very lucrative, articles.

In the second place we find well-nigh everywhere the abandonment of the old general property tax regarded as a personal impost.[1] In England and Germany it disappeared during the eighteenth century; in France it was abolished by the Revolution; in America, where the economic conditions brought it into life during the eighteenth century and the early part of the nineteenth, it is beginning to break up in those sections where the agricultural economy is giving way to a commercial and industrial economy.

Thirdly, we notice everywhere the replacing of the general property tax by taxes on the thing rather than on the person. In other words, personal taxation is giving way to impersonal

[1] *Cf.* for details chapter ii, *supra*.

taxation. In the local tax on real estate this process has been carried almost to completion. In Europe, for instance, the taxes levied on the land and on the house are assessed irrespective of the owner or of the relations that may be entered into between owner and tenant. Everywhere in Europe the tax is a tax on the produce of the land or house—that is, upon what it yields in the shape of rent or of profits equivalent to rent. In some countries, as in England, the tax is not paid by the owner at all, but by the occupier. Even in the United States the tax is beginning to be assessed on the parcel of real estate and not on the individual who owns it. Whether the owner or some one else pays the tax is immaterial, and if the tax is not paid, no regard is paid to the owner and the land itself is sold. We could get scarcely further away from the old idea of individual taxation. The tax is a tax on the thing and not on the person.

In New York, for instance, the older method like that in all the commonwealths, had been to make the owner of the land personally responsible for the tax on real estate, just as in the case of personal property. If he failed to pay, the remedy was distress on the individual and, in case of failure to find sufficient chattels for the levy, arrest. This system broke down at an early period so far as non-resident owners were concerned, and in such cases the tax was made a lien on the land itself, with power to sell the land in case the tax was not paid.[1] It was not until 1850 that the system of taxing non-resident lands was applied in the city of New York to the lands of residents also. But even then it was for a long time the exception rather than the rule, and the courts were slow to recognize the nature of the change.[2] But what was originally the exception became before long the rule, until at the beginning of the twentieth

[1] In Massachusetts this power first appears in 1731. See the history of the legislation in that State in Richardson *vs.* Boston, 148 Mass. 508.

[2] It is true that in the case of Haight *vs.* The Mayor, *etc.*, of the City of New York, 99 N. Y. 280, the court held that "the only effect of omitting to insert the name of the owner is to deprive the City of the right to collect the tax from the owner personally or by distress of goods and chattels, *etc.*, and to confine its remedy for the collection of the tax to the enforcement of its lien therefor on the land assessed." But on the other hand in the case of Hagner *vs.* Hall, 10 Appellate Division, p. 585, the court said: "Still in my opinion this has not changed the effect of the proceeding. It is essentially a proceeding to create a debt against an individual. The individual is the primary debtor and the land is only in the nature of surety liable for his default."

century the assessment of all real estate in New York city was made by lot and block. It had become in other words, a geographical or topographical assessment, instead of an assessment to the owner or person. This method spread to a few other cities in the states. The State Board of Tax Commissioners in various successive reports recommended a change in the general state law, whereby the distinction between resident and non-resident assessments should be abandoned, and all real estate assessments should be *in rem*, *i.e.*, against the land itself. This was officially accomplished in 1911 when it was provided by law that throughout the state of New York the name of the owner of the real estate should no longer be essential to the validity of the assessment, provided that the property were described in sufficient detail to identify it. Of the incidental possibilities of improvements which this law may bring about in the assessment of the real estate tax this is not the place to speak.

In the other so-called direct taxes, a similar development is to be observed. The business taxes in Europe are levied upon the business as such and not upon the owner of the business. The inheritance tax is in many countries levied upon the inheritance and not upon the individual who receives the inheritance. The general land tax in England—the last vestige of the mediæval general property tax upon individuals—has actually become a redeemable rent-charge. Even the income tax, which in theory is assuredly personal, has, as we have already stated, in some places at least almost completely lost its individual character and has become in great measure a tax upon the thing affording the income rather than upon the person receiving the income. In the United States the so-called personal tax, that is, the tax on individuals according to their personal property, is fast becoming a farce in all the older centres. The problem is really a deeper one than the German scientists have usually recognized. It is not so much a conflict between a tax upon produce and a tax upon income as it is a conflict between the social and the individual bases of taxation.[1]

[1] In two recent articles in Schmoller's *Jahrbuch für Gesetzgebung, Verwaltung und Volkswirthschaft*, Professor Gustav Cohn, of Göttingen, criticizes this position. In his article on "Charakterzüge des Amerikanischen Steuerwesens," in vol. xxiii. (1908), p. 431 *et seq.*, he contends that the only reason why the United States is not more quickly adopting the principle of faculty or ability to pay is that conditions are so unripe here. He has no faith in any attempt to explain matters by a new principle. In

In the fourth place, we find everywhere an increasing importance attached to corporations as the source of revenue. In Europe this process is somewhat concealed because of the inclusion of the revenue from corporations in the income tax, just as in many of the younger American commonwealths the revenues figure in the general property tax. In the older states corporation taxes are put into a separate category, and in some states, as in New York, they are even called indirect

the second article which is in substance a leading review of my book on *The Income Tax*, in vol. xxxv. (1911) of the same journal, entitled "Die Einkommensteuer in den Vereinigten Staaten von Amerika," Professor Cohn welcomes what he calls my reversion to the principle of faculty, but twits me with abandoning my former position.

The problem, however, is not one of inconsistency at all nor is it, as Professor Cohn seems to think, simply a question of choice between direct and indirect taxation. To anyone who is acquainted with American conditions, it is plain that two distinctly opposed tendencies are at present perceptible in our fiscal development. On the one hand we find the tendency toward the adoption of the principle of individual faculty or ability in taxation, typified primarily in our federal finance by the tariff-reform and the income-tax movements. On the other hand, there is the tendency in our states and cities away from personal taxation in the shape of the general property tax and toward the adoption not only of indirect taxes in the older sense but also of impersonal "real taxes," *i. e.* taxes on things. These two movements are really not opposite, but complementary; just as in the political life of most countries we notice the simultaneous action of forces, some making for centralization, others making for decentralization. When I advanced the "social theory" of taxation in 1904 I had in mind especially the American problem of state and local taxation; when I emphasized in 1910 the faculty theory of taxation I was discussing primarily the national problem. There is nothing inconsistent, as Professor Cohn believes, in these two standpoints. In other countries at present, and possibly in the America of the future, the problem may not be that of national *versus* state or local taxation, for the interrelations of local and national finance may be quite different from what they are at present in the United States. That the problem, however, is everywhere one of the social *versus* the individual point of view, and that the tendency toward the adoption of the principle of individual faculty is inadequate to explain all the phases of the modern movement will, I fancy, not be disputed by competent observers in England or France, and ought not to be elude the vision of even the Germans themselves, especially since their federal tax reform of 1910. The real trouble with the German writers on public finance during the last generation, so far as this point is concerned, is that they have centred their attention exclusively on the movement to replace for state purposes the old taxes on product by the new income and inheritance taxes, to the neglect of the simultaneous, and in some respects equally important, movement away from the principle of individual faculty in national, state and local finance. What I have sought to do is to attempt an explanation of both tendencies.

taxes in contradistinction to the direct or property taxes. Everywhere, however, they form a problem of increasing importance and present an admirable example of what is meant by taxation from a social rather than from an individual point of view. Taxation of the corporation does not necessarily mean taxation of the security-holder who has purchased the stock or bond from the original holder.[1]

The main outlines of the development of the immediate future, throughout the world, are thus fairly clear. Each country will continue to have its particular problems based upon its special economic and political needs. Everywhere there will continue to be an attempt to realize the principle of fiscal justice, interpreting it, however, more and more from the point of view of social interrelations rather than from that of individual conditions. The statesmen and scientists alike will find the great difficulty of the future to consist in attaining this due proportion between the undoubted needs of the individual and the consequences of his participation in the social group. For we must not forget that while it is necessary to regard the ultimate results of all fiscal policies, the immediate results are often of primary practical importance. The conflict between immediate and ultimate results is another way of putting the contrast between the individual and social aspects of finance. To realize the truth contained in the latter, without disregarding the legitimate importance of the former, is the problem reserved for the coming decades.

[1] *Cf. supra*, p. 309.

CHAPTER X

A QUARTER CENTURY'S PROGRESS IN TAXATION [1]

I. *General Progress*

THE subject of this chapter is susceptible of a double treatment. It covers not only the actual changes of a fundamental nature in the practice of taxation, but also the development that has taken place in the governing principles. These, however, are, after all, two phases of the same movement, for the influence of practice and theory is reciprocal. On the one hand, the theories themselves represent an outcome of the facts, for fiscal theory, like all social theory, is but an attempt to present an analysis of the living forces at work in industrial society. And on the other hand, so far as fiscal theory deals with what ought to be, rather than with what is, it justifies itself only to the extent that its conclusions are approved by the popular mind, and thus become incorporated in the actual bone and sinew of the social organism. Fiscal theory and fiscal practice are the obverse and reverse of the same medal.

In the second place, the problem is not only specific but general. As citizens and patriots we are naturally most interested in the problems of our own country; but as scientists, our horizon is a wider one. Science cannot be fettered by bonds of national forging. It soars far above such limits. This is especially true of the scientific problems of taxation. It goes, of course, without saying that the fiscal institutions of every country, as all its economic and social institutions, are colored by the particular environment. It would therefore be hopeless to attempt to reproduce in any one country, in all its minute details, the institutions of another country. But while we may concede the diversity of conditions, and the peculiarities of national life which must guide the states-

[1] This chapter is in substance a reproduction of the address delivered at the Twenty-fifth anniversary meeting of the American Economic Association in 1908, and published in the *Proceedings* for that year.

man in elaborating any specific plan, it is equally true that there are discernible certain broad and general tendencies which are common to the life of all modern progressive societies, and which constitute the special field of the scientific observer. We shall see indeed that however much individual countries may differ from each other, and however confused the actual scheme at first blush may appear, there is, as it were, a silken strand which runs through the tangled skein, and which serves to give unity to what seems disorder.

And finally, we are struck, in this introductory survey of a quarter century's progress, by the fact that the science of finance is only slowly coming to its own, as compared with the almost revolutionary development in the general theory of pure and applied economics. This is due to the fact that the really difficult fiscal problems are of recent origin, and that fiscal science rarely grapples with problems until they have became acute. In Germany and in Italy the difficulties arose at a slightly earlier period; and we hence find a considerable scientific activity, along several lines at least, at the beginning of the period under discussion. In other countries, and notably in England, France, and the United States, the problems have been of much later growth, and it is accordingly only in the last few years that we find increasing attention paid to the underlying principles of tax adjustment. Even in Germany and Italy the rapid changes of industrial environment have, in many respects, shifted the centre of gravity, and have recently engendered newer problems which are common to the whole civilized world. It is, however, not only in Germany as in France, in England as in Japan, that the fiscal problem is at the present time in the very forefront of political and social discussion. Especially in the United States it is a phenomenon of the most cheering import to note how the younger scholars are now beginning to address themselves to a consideration of these vexing problems. The progress that has been accomplished in the last quarter of a century is an earnest of the far greater development that is imminent in the immediate future.

Before taking up the question of fiscal theory, however, one fact must be noted as of paramount importance. It is the increasing significance everywhere being attached to administrative considerations. What is true more or less of all economic institutions is particularly applicable to our special

problems. On all sides we are realizing the fact that the question of efficiency is scarcely, if at all, subordinate to the question of justice. Or, let me put it rather in this way: that however well justified, and however thoroughly calculated to promote the ends of justice a given scheme may be, unless its administrative features are so arranged as to make it workable, the beneficent aims are bound to be frustrated; and a half-way good measure which is administratively unobjectionable frequently turns out to be far superior to an ideal scheme which ultimately discloses serious faults in its administrative aspects. It is for this reason that we notice so much attention paid throughout the world in recent years to the administrative machinery, or to the purely mechanical aspects of the problem. In both England and Germany, for instance, the past quarter of a century has seen a marked improvement in the administrative processes of the income tax, and especially in the former country has rendered palatable a system which was originally viewed with misgiving and distrust. Those authors—and they are not yet entirely extinct—who endeavor to draw a warning lesson from the income tax, derived from the speeches of Gladstone and the writings of an earlier generation of economists, are not alone blind to the teachings of the more recent movements of theory, of which we shall speak in a moment, but are, above all, deaf to the lessons of administrative development. Even in the United States, where great and fundamental changes in the structure of taxation are impending, it is coming more and more to be realized that even our present system, inadequate and unsatisfactory though it be, is susceptible of a prodigious improvement on purely administrative lines. We have but to call attention to the remarkable progress that has been achieved in the administration of the tax on real estate in the city of New York, under the skillful supervision of the capable head of the Commissioners of Taxes and Assessments. Another more or less familiar example is the excellent work that has been done in the state control of local officials, or the centralized administration of the general property tax, in commonwealths like Minnesota and Wisconsin, where the political powers have seen fit to call to their aid scientifically trained fiscal administrators. In fact, if there is any one thing which looms large in the history of the last twenty-five years in the United States, it is the increasing significance that is now slowly being attached to the problem

of administrative efficiency. In this alone lies no small measure of our hope for the future. The administrative problem lies, however, beyond the confines of this discussion.

II. *Local Considerations and the Benefit Theory*

Assuming, then, that the problem of administrative efficiency is being successfully attacked, we must now address ourselves to those underlying principles which, after all, form the touchstone of ultimate fiscal success. If we take a broad survey of the theory and practice of the last twenty-five years' taxation, we shall be impressed by two fundamental reflections. The first is the emphasis that is being placed upon social rather than individual considerations; and the second is that even in so far as this is not true there has been a decided change in our attitude to the individual norm in taxation. Let us consider these separately.

The first point is one which I have repeatedly accentuated in the last few years, and which, therefore, will call for less elaboration in this place. Whatever theory the older writers on taxation might have advanced as to the obligation of the individual to contribute to the support of government, they always tacitly assumed that the so-called direct taxes rested upon the taxpayer; and in this scheme of equitable taxation there was manifestly no room for a system of indirect imposts. One of the most striking facts in the literature of taxation is that we search in vain for an adequate explanation, not to speak of justification, of a set of revenues which in almost every country forms the considerably greater part of the whole. To say, as did a well-known writer some years ago, that all indirect taxation is crooked taxation—importing into the term a moral as well as a physical connotation—is seriously to impeach the entire modern development. It is indeed true that the civilized world has abandoned the mediæval system of a multiplicity of indefensible and burdensome indirect taxes. But it is also true that their place has been taken by taxes which are less burdensome and more defensible indeed, but none the less equally indirect taxes. One has but to run through the budgets of any modern nation, in order to realize what a very considerable share of the revenue is derived from so-called indirect sources; and in many cases the proportion is becoming greater, instead of less. Even in the United States, where the import

duties and the internal revenue taxes form the almost exclusive source of national income, the trend toward indirect taxes even in the commonwealths is typified by the stock-exchange tax as in New York and the mortgage tax, which now constitutes in some states an important source of commonwealth revenue. And if we look at the admirable scheme by which Japan has been able to arrange her war and her *post bellum* finances, we are equally struck by this preponderance of the so-called indirect taxes. Of the situation as it exists in France, in Italy, in Germany, and in England, we need not speak at all.

A theory of taxation which is competent to explain the modern development must, therefore, put us in the way of comprehending the real principle underlying the indirect taxes. But it must do more than that. It must also put us in a position to understand the break-up of the general property tax and the change taking place in the taxation of mortgages throughout the country. Or again, it must enable us to explain how it is that in the great city of New York almost the entire tax revenue can be derived from an impost on real estate, without engendering a revolution among the particular class of property owners that is singled out for taxation.

The truth of the matter is that things are not what they seem; that the older theory that justice can be attained by taxing every man on all his property does somehow not work out, because, as a matter of fact, the taxation of property is not necessarily taxation of the property owner. In other words, we are confronted by the great problem of the shifting, the incidence, and the effects of taxation. The individual taxpayer does not live to himself alone; he forms a part of a delicate and complex organism, and his interests are indissolubly bound up with those of his neighbors. The problem of taxation, like every problem of value, is primarily a social and not an individual problem. The striking change that has come over modern economics is the emphasis that has been put upon the social aspects of theory. If there is any one thing that is needed in the science of finance, it is the point for which I have clamored so insistently during the past few years, that the newer theory of taxation must proceed from the social, and not the individual, point of view. It is this point of view that is responsible for the more modern version of the theory of diffusion or absorption of taxation. It is this point of view which emphasizes the newer doctrine of capitalization of taxation. It is this point of view

which unites the doctrines of absorption and capitalization in the wider theory that I have ventured to call the elision of taxation. Slowly we are beginning to realize—and by we I mean not alone the representatives of science, but the legislators and the courts—that to tax a particular piece of property is not necessarily to tax the property owner; that to attain justice in taxation it is not requisite to tax all kinds of property; and that in the case both of the so-called direct, and the so-called indirect taxes, the real problem is not as to which individual advances the tax, but as to what class of individuals ultimately pay the tax, or are either burdened or benefited by it.

In this respect, therefore, the progress of theory in the last twenty-five years has scarcely kept pace with the unconscious revelation of the theory in the facts of actual life. A beginning has been made, but only a beginning; and the task of the next quarter of a century is to carry out into all its ramifications an elaboration and a more adequate comprehension of this doctrine of the social, rather than the individual, forces in taxation.

It may be claimed, however, that there still remains a field for the application of the individual theory of taxation, because it is undoubtedly true that in many cases, at all events, a tax is not shifted, but is really borne by the individual who pays it. Although we may grant this contention, it is, I think, susceptible of proof that even from the individual point of view a great change has taken place in the facts of modern taxation, which must inevitably react upon the theory; and that even this putative individual basis of taxation will, on closer examination, be found to be shot through with social considerations.

We come, in other words, to the great question which has long vexed the minds of scholars and taxed the energies of statesmen, as to what really is the test and measure of the obligation of the individual to contribute to the support of government. Even assuming that every individual bears the burden of what he actually pays to the state, how shall this burden be apportioned? Two answers, as is well known, have been given to this query. Yet each has failed to satisfy the rigorous demands of modern investigation; the one because it is plainly inadequate, the other because it has hitherto been incorrectly interpreted.

The answer that was almost universally given in the earlier stage of fiscal inquiry was that individuals should contribute to the support of government in accordance with the benefits or advantages which they derived from government action.

This has now become known as the Benefit Theory of taxation. The state was conceived of as a large joint-stock company, in which the individual citizens were shareholders; and each citizen was imagined to derive from the operation of this corporation a definite amount of profits in accordance with his investment in the enterprise. Since the operations of government were not designed to yield a dividend in actual money, the profits were conceived of primarily as being something in the nature of an intangible, but none the less calculable, dividend; and since, in the minds of those writers, the chief and well-nigh the sole function of government was to protect life and property, the quantum of benefit that each individual received stood in a certain proportion to his wealth. Taxes hence represent nothing but an insurance premium, or a periodic payment made by the individual in order to guarantee the continuance of his profits in this joint-stock enterprise. The theory of benefit or protection, although now almost completely abandoned by scholars, still lingers in the minds of some writers, and is found to a considerable extent in the tax decisions of the courts of Anglo-Saxon countries, where the force of precedent is so enormous.

The reason why the benefit theory of taxation has been abandoned is two-fold. In the first place, even on the assumption that the theory involves a correct interpretation of the relations of the individual to the government, a more rigid analysis discloses the fact that the benefits conferred by government on individuals do not stand in any such relation to wealth —whether to property or to income—as had been imagined. Even granting that the sole function of government is to protect property, it does not follow either that it costs the government twice as much to protect property of twice the amount, nor that the smaller property owner feels that he is getting only one-half the benefits on his own property that the larger proprietor receives on his. Furthermore, it is obvious that the government protects persons as well as property, and the personal protection realized by a poor man is no less valuable to him than the personal protection afforded to a rich man. Still further, however, it soon became apparent that government is more than the mere watchdog of society, and that protection does not exhaust its functions. As soon, however, as we consider the other functions of government, the fallacy of the benefit theory becomes evident. For the advantages derived

by individuals from government action are found to be in large measure not in direct, but in inverse, proportion to their wealth. The poor man sends his children to a public school, the rich man resorts to a private school; the poor man depends for fire protection or sanitation upon the efforts of government, the rich man avails himself of the services of the best appliances and the foremost experts; the poor man, in last instance, resorts to poor relief or state pensions; the rich man needs no such assistance. In almost every domain of modern governmental activity, it may thus be contended with some degree of truth that the direct benefits of state action are frequently in inverse proportion to the wealth of the individual. A theory which would practically result in placing greater burdens upon the poor man than upon the rich man must, therefore, be defective in one of its premises.

The second and chief reason, however, why the benefit theory of taxation was abandoned is that the whole foundation of political philosophy on which it was erected was recognized as insecure. The modern theory of political science rests upon the more organic conception of the relation of the individual to the state; it recognizes the fact that the public collective wants are as much a part of the nature of civilized man as are his individual private wants; and that the essence of taxation is a moral, as well as a legal, obligation. The government, indeed, must do something for the community in return for the support which it receives. But this reciprocal obligation on the part of the government is not toward the individual as such, but toward the individual as a part of the greater whole. The special benefit is swallowed up in the common benefit. The special benefit to the individual is, in most cases, even not measurable; for the distinguishing characteristic of modern civilization is the spread throughout the community of these impalpable, non-material results of good government which make for the common welfare, and especially for the higher life. In its ideal form at all events, the state must be likened not to a joint-stock company, but to a family. The citizens are not stockholders but brethren, animated, if they are patriots, by the same ideals and by the same fine sense of co-operation in the common interest. Whatever the test of this moral obligation to contribute to the support of the whole may be, it is, in the state as little as in the family, assuredly not the measure of benefit received. Not only is the test wholly imprac-

ticable, but if it were practicable it would be completely inadequate.

It may be claimed, indeed, that this analogy of the state to the family is strained, and that cases do arise where the government undergoes a certain expense, and actually performs a definite service, for the particular individual, the benefits of which are separably and measurably calculated. Such a case obtains, for instance, when the government sells gas to the individual, or makes a charge for a certain permit, or demands that the cost of an improvement which inures particularly to the benefit of a given set of individuals be borne, in whole or in part, by them. While this claim may at once be conceded, it must be pointed out that such payments do not come under the head of taxes, properly so called. Even though there is still much confusion in the minds of our legislators and our judges, we cannot help realizing, as we look back upon the progress of the last twenty-five years, that one of our chief steps in advance has been a more proper classification of public revenues, and a recognition of the fact that taxes must not be confused with prices or with fees or with special assessments. What we have to treat of here is not the whole subject of government revenues, but the special topic of taxation. In a tax the point of chief importance is the prevalence of the common benefit, and the purely incidental character, if it exists at all, of the special benefit to the individual. Where the special benefit to the individual is separately calculable, and is no longer a purely incidental result of government action, we are dealing with something that is not a tax at all.

III. *Social Considerations and the Faculty Theory*

When the benefit theory of taxation was abandoned it was replaced by the faculty or ability theory. This theory taught that the measure of general obligation to the support of government is, in the state as in the family, the capacity on the part of the individual to contribute to that support. This seemed to be an enlightening and comprehensive proposition. But, as in the case of the benefit theory, the difficulty arose when an attempt was made to analyze more closely exactly what was meant by the faculty principle. Perhaps the most important step in the analysis was taken by those writers who, like John Stuart Mill, conceived the essence of faculty or ability to reside in equality

of sacrifice. That is, they measured the ability of the individual to pay taxes by the amount of sacrifice that would be imposed upon him by the burden of the payment. I do not here speak of the various suggestions that have been put forward to ascertain the objective norm of this faculty so interpreted, further than to recall the gradual evolution from the test of expenditure to that in turn of property, of product, and of income. The important point for our purpose is that the subjective measure of the obligation was found to consist in sacrifice. It is true, indeed, that in recent times this explanation of Mill has been further elaborated, as, for instance, in the suggested substitution by Professor Edgeworth and by Professor Carver of the principle of minimum sacrifice, in lieu of that of equal sacrifice. But apart from the peculiar difficulties inherent in this newer version, upon which this is not the place to touch,[1] we are confronted by the fact not only that fiscal practice does not conform to the general theory of sacrifice, but that the doctrine of ability or faculty itself has been assailed by recent thinkers as in some respects unsatisfactory.

While there is some force in the objections that have been urged, they are, in my opinion, not sufficient to invalidate the doctrine of ability or faculty, if correctly interpreted. Almost all the modern writers on finance, in Germany as well as in England and elsewhere, have regarded faculty too exclusively from the point of view of consumption. The whole sacrifice theory, whether in the equal-sacrifice or in the minimum-sacrifice version, deals only with this phase of the problem. It asks what is the burden that rests upon the individual in virtue of his payment of taxes; and how much of his property or income remains for purposes of his own consumption. It is through and through an essentially consumption theory of finance. A more careful analysis of the doctrine, however, and one that is more in harmony with the actual facts, forces us to the conclusion that the consumption side of the theory must be reinforced by the production side. In estimating a man's faculty or ability to pay we must not alone think of the burden imposed upon him in parting with his property or income, but we must also consider the opportunities which he has enjoyed in securing that property or income.

But what, it may be asked, is the real import of this? The

[1] For a discussion of these doctrines see Seligman, *Progressive Taxation*, 2 ed. (1908), pp. 285–289.

answer is obvious. Manifestly, as soon as we regard the production side of the problem, we are confronted by the phenomenon of privilege in all its manifold forms. If an individual secures his wealth largely through his own unaided exertions, that is one thing. If, on the contrary, his fortune is in great measure ascribable to the privileges conferred upon him by law, the situation is a very different one. The privileges render it easier for him to create and to augment his wealth, and the real sacrifice involved is the sacrifice of acquisition, as well as that of disposition. The older theory of faculty dealt only with the latter kind of sacrifice; the newer theory of faculty must include both kinds.

The doctrine of ability or faculty, as thus reinvigorated, is not only free from objection; it is, because more inclusive, superior to any of the rival conceptions that now divide the camp of fiscal thinkers. Our friends, the single taxers, for instance, who have done such yeoman's service in many phases of fiscal reform, commit a double mistake; first, in singling out a particular privilege as the only one to be reckoned with; and, secondly, in erecting the principle of privilege into an independent and all-sufficient explanation of the relation of the individual to the government. Some of them, in the ardor of their reaction against the faculty theory, even go so far as erroneously to identify the privilege theory with the benefit theory, and thus revert to the old and discredited explanation. But even those who do not go to this length nevertheless see in the doctrine of privilege an all-embracing and adequate principle. As I have attempted to point out above, however, this view is essentially incorrect, because it looks at only one-half of the problem. It regards solely the acquisition of wealth, and is oblivious of the disposition of wealth. The older faculty theory, as it has been almost universally expounded, errs on one side of the question; the privilege theory errs to an equal extent on the other side. The only satisfactory solution of the problem is, while upholding the faculty theory of taxation as over against the old benefit theory, so to broaden and interpret the faculty theory as to make it include all of what is legitimate in the privilege theory, without incurring any of its extravagances.

This new interpretation of the faculty theory also enables us to explain the actual progress of events during the past quarter of a century. On the one hand, we have the great movement toward the income tax, a movement which is perceptible in the United States as well as in France and the other European

countries. This movement is the direct result of the older elements involved in the faculty theory. It is a recent movement in the United States simply because the whole faculty theory of taxation is of comparatively modern acceptance. But the two newer modifications of the income tax which are now being so hotly discussed all over the world, the principle of graduation, and the principle of differentiation, are, consciously or unconsciously, the result in part at least of the other side of the faculty conception. As I attempted, many years ago, to point out in the discussion of progressive taxation, the consumption side of the theory alone does not suffice for an adequate defence of the principle. And in the case of the distinction between earned and unearned incomes that has now come to the fore with such insistence in Great Britain as elsewhere, the justification of the higher rates on unearned incomes is to be sought in large measure in the principle of privilege, and especially the privilege of inheritance. It is the same privilege of inheritance which is responsible for the great development in recent years of the progressive and the collateral inheritance taxes all over the world; and it is a social privilege of a different but of not less important kind, which has brought into the forefront of political discussion in Germany, and in England, the increment duties on land. In the United States also the federal corporation tax and the corporate franchise taxes in our commonwealths are all of them referable at bottom to this newer idea of social or legal privilege as augmenting the faculty or ability of the taxpayer, whether individual or corporation. Far from working away from the theory of faculty, the events of recent years show a decided approximation to the doctrine as correctly interpreted.

We see, therefore, that the chief development of the last quarter of a century, in the practice as well as in the theory of taxation, has been the increasing emphasis laid upon the social point of view. In a great domain of taxation, as we have just learned, the individual point of view has been completely superseded by the social point of view, and the study of the incidence and effects of taxation has emphasized to a continually greater extent the fact that the individual who pays a tax is by no means always the person who bears the tax. And secondly, as we have also seen, even in that remaining field of taxation where the individual taxpayer is the tax-bearer, and where the theory of faculty or ability to pay has been predicated as a fundamental principle, the individual element in this theory has been supple-

mented by the social element. The older conception of sacrifice was an individual conception; the newer idea of privilege is a social conception; these two conceptions have joined to form the modern doctrine of capacity or ability to pay.

Thus, from every standpoint, the individual idea has been permeated with social considerations, and the theory of finance is taking its place side by side with the other economic doctrines, as forming an outgrowth of the modern application of social considerations to the older individual conception. Economics is now sometimes called Social Economics; the newer theory of finance might also well be called the Social Theory of Finance.[1]

IV. *Conflicts Between Tax Jurisdictions*

No survey of recent tendencies in taxation would be complete, however, without some allusion to the changes that have been brought about by the question of various tax jurisdictions, and of the conflicts between them. In all modern nations we are struck by the attempt to adjust the fiscal relations of state and locality; and in all federal commonwealths we have the added complication of the adjustment between state and nation. What does the experience of the last twenty-five years teach us with reference to both the theory and the practice of these problems?

Let us take up first the question of the relation of general and local finance. Here we at once notice the obvious fact that the tendency everywhere is to confine the local tax to real estate. Originally, as is well known, all taxes were primarily local; and we therefore find local revenues derived from a whole category of imposts. Everywhere the general property or the general income tax formed a large part of the local revenue, and in earlier times it was supplemented by a code of taxes on consumption, a system which still survives in many cities of the European continent. When state taxes developed, they were either tacked on to the local revenue, as is still the custom in the United States; or where tax administration had become national, as in France and some other European countries, the reverse process occurred and local taxes were now tacked on to the state revenues. It is here now that we

[1] This theory is not to be confused with the socio-political theory of taxation which is sometimes associated with the name of Adolf Wagner, and which has been elsewhere discussed by me. See Seligman, *Progressive Taxation*, 2 ed. (1908), pp. 129–132.

notice a most instructive evolution. I need not stop in this place to emphasize the great economic changes which rendered the general property tax of earlier days unfitting and inoperative. But I do want to accentuate the fact that has been lost sight of, that the reason of the decay and the disappearance of the general property tax all over Europe was not only the break-up of the original mass of property into its constituent elements, but also, to an equally great extent, the fact that the administration of the general property tax remained local, while the basis of the revenue derived from property was now becoming general. In other words, an important cause of the failure of the general property tax was the attempt to apply local administrative methods to what was now essentially fitted only for general administrative methods. Individual property and individual income can not, in modern times, be localized; and therefore a local tax on general property or general income becomes increasingly difficult to administer. This is one of the chief reasons why the general property tax is becoming a farce in the United States, just as it explains why it has long since disappeared practically everywhere else in the civilized world. But it also enables us to understand the reason why the modern income taxes, and even the property taxes where they exist, are based upon the broader, and not the narrower, administrative foundation.

What applies to the general property tax applies to many other general taxes. The one important category of revenue, however, to which this administrative shortcoming does not apply is the tax on real estate, and thus everywhere we find local taxation coming more and more to assume the form of a tax on real estate. In some countries, as in England and Australia, this is now the fact by law. In some places, like the more developed industrial centres of the United States, it is now virtually a fact by custom. In France, indeed, the movement has only just begun, but is quite perceptible; while in Germany the well-intentioned reforms of the early nineties have been in part blocked by the selfish but unreasoning opposition of the landowners, who do not quite realize the true economic significance of the process. Indeed, with all the disadvantages and absurdities of our American system I should say that the system of local taxation in the United States, as it is fast developing in actual practice in the most advanced communities, is superior to that which exists in Germany or

in France, and even in some important respects not inferior to that which is found in England. The trouble with our American scheme is that the facts are developing in spite of the law, and not in accordance with the law. The tendency, however, throughout the world toward reliance for local revenues upon the real estate tax is not alone indisputable, but also in complete harmony with the newer theories of finance.

The other side of the problem, namely, the relation of state to federal finance, has come to the front primarily in great empires like Germany, Australia, Canada and the United States. In this country we are at the present time in the very throes of the discussion. As we have pointed out elsewhere at some length,[1] the real considerations involved in the choice of revenues for conflicting tax jurisdictions are the considerations of efficiency, of suitability, and of adequacy. Into the further discussion of these subjects I do not intend here to enter. But one point calls for especial emphasis. The situation in the United States is far more difficult than that in most of the other empires mentioned, because of our system of constitutional restrictions. The older I grow and the more deeply I work into our economic and fiscal problem, the more seriously do I question the value of our much-lauded system of constitutional restrictions, at all events as applied to the problems in hand. We see the embarrassments on all sides. All the other countries have been able, for instance, to rid themselves of the general property tax, while we shall have to devote many an arduous year to the effort to overcome the initial restrictions in most of our state constitutions. And so far as this particular problem of the relation of federal and state finance is concerned, the much greater progress that has been shown by our Canadian neighbor, not to speak of some of our friends across the seas, is due to their happy immunity from the dogma of state rights. Simply because of the accident that when our constitution was formed the separate states were independent and jealous of each other, we have embedded into our constitution the theory that all rights not expressly granted to the national government are reserved to the states. Yet immediately across the border we have a nation which is to-day more than twice as populous as was ours when the constitution was framed, and which in no distant future is bound to become as great and as mighty an empire as our own;

[1] *Infra*, chap. xii.

and yet Canada has prospered on just the reverse theory, namely, the theory that the rights not granted to the states are reserved to the national government. Under this system Canada is solving not alone her fiscal problems, but many other economic problems, in a far more successful way than are we. And what is true of Canada is true, in a large measure, of the other great federal states. We have shackled ourselves with bonds which now cramp and bind our well-rounded development. We have erected into a fetish of so-called state rights or local self-government, a theory which the successful career of other Anglo-Saxon empires has shown to be unnecessary and embarrassing. The experience of the last twenty-five years, if it conveys any lesson at all in fiscal as well as in economic matters, teaches us that our whole constitutional theory deserves considerable overhauling.

Putting these considerations into practical form it means, as I have attempted elsewhere to indicate, that the income tax of the future in this country is to be in first instance a national income tax; and that so far as the corporation tax and the inheritance tax are concerned, the almost insuperable obstacles to overcoming the difficulties of interstate conflicts of tax jurisdiction may be removed by a national supervision of the taxes imposed by the states, or by some scheme whereby the taxes in question will become national, so far as the methods of assessment are concerned, even though the proceeds may be apportioned in whole, or in part, to the separate commonwealths. In some way or other the legal facts must be made to conform to the economic facts. In some form or other the structure of government must be put into harmony with the content of economic life.

The last quarter of a century, therefore, which has seen such enormous changes in the economic basis of society, is bringing about equally vast changes in the theory and practice of taxation. Summed up in a few words, this movement means, on the one hand, the reconciliation of efficiency with justice, or rather the attainment of justice through efficiency; and, on the other hand, it means the correlation of the older individual and the newer social elements in the problem. The struggles over the budget in England, over the income tax in France, over the revenue code in Germany, are all of them symptoms of this newer spirit. And in the United States the effort to abolish the iniquitous general property tax; the attempt to secure a

separation of the sources of state and local revenue; the development of a system of state supervision over local assessments; the endeavor to hold individuals and corporations up to their obligations to the treasury; the movements to modify our system of import and internal revenue duties, and to supplement them by an income tax; and above all, the tendency toward the spread of the inheritance tax and the incipient discussion as to the applicability of the theory of unearned increment to land taxes,—all of these but emphasize the lesson which we have sought to convey. The civilized world, in its rapid onward sweep, is fast realizing all these newer ideas in taxation. It remains for the student to analyze and to explain the situation, and by clarifying the conceptions of statesmen as to the real import of these vast changes, to put them in a position to become the leaders of the people, who are the ultimate arbiters in this quest for justice and in this endeavor to reflect in fiscal institutions the highest aims of economic and social progress.

CHAPTER XI

THE SEPARATION OF STATE AND LOCAL REVENUES [1]

I. *The Present Difficulties*

THE discontent with the conditions of American taxation is growing apace. The reason is not far to seek. On the one hand, the development of industrial democracy is everywhere creating greater demands upon the public purse for a collective action which shall be in the interests of the entire community; on the other hand, the growth of prosperity and the transition from more primitive economic conditions to those of a complex industrial society are rendering more and more inadequate the fiscal basis and the fiscal machinery which have been bequeathed to us by our ancestors. Thus at both ends the pressure is felt. The fiscal needs are multiplied and the fiscal machinery is getting out of gear. Expenditures are growing, and the old forms of revenue are no longer suitable. Hence the pressure of public needs upon public resources. And since these public needs are augmenting most rapidly in the domain of local rather than of national government, it is primarily questions of state and local revenues that are becoming increasingly embarrassing.

It would be a mistake, however, to suppose that the public resources are in themselves inadequate. The fault does not lie with the social income. National prosperity is great and growing, and the increase of wealth and of social income is proceeding unchecked. Were our state and local resources marshalled and organized for fiscal purposes as is done by the national government, the embarrassment would soon vanish. We all know that in normal times there has never been the slightest difficulty in securing a revenue for national purposes which should be, not only abundant, but on the whole satisfactory to the community. We know equally well, however,

[1] This chapter is reprinted with some changes from the paper in *Addresses and Proceedings of the First Annual Conference of the National Tax Association*, New York, 1908, p. 485 *et seq.*

that what has been so successfully done by the national government is very imperfectly accomplished by our state and local governments. The wealth is there, the resources are there, but the method of tapping the resources has become unsatisfactory, lopsided and unequal. What is needed is a readjustment of the system to make it fit modern necessities.

In an empire like the United States the problem will naturally assume a somewhat different form in various sections. Finance and politics are but the ultimate expression of economic forces and relations, and the economic conditions vary widely throughout our country. The transition from the frontier life and the activity of a purely agricultural community to the conditions of a highly developed and complex industrial community has made far more progress in some sections than in others, and to the extent that this transition has only begun, the older methods possess a certain measure of validity. What is good for New York is not necessarily good for Mississippi, nor again for Utah. But notwithstanding this diversity of economic conditions, there are certain phenomena which are common to all. The large corporate agencies of transportation are found throughout the country. Some of the great trusts are selling their products in the little hamlets as well as in the important commercial centres. Certain defects in our fiscal system are therefore being recognized as common to the whole country, and with the development of more homogeneous economic conditions this is bound to be increasingly true in the future. We have tax commissions wrestling with very much the same problems, not only in Massachusetts and New York, but in Minnesota and Wisconsin; not only in Louisiana, but on the Pacific slope.

What, then, are the chief difficulties in our tax system which are coming more and more to be recognized everywhere throughout the length and breadth of the land? I should sum them up under eight heads.

First and foremost is the breakdown of the general property tax, which is almost everywhere still the chief reliance of state and local government. The general property tax works well only amid most primitive economic conditions for which alone it was calculated. Almost everywhere, for reasons which it is unnecessary here to recapitulate, and which it is utterly impossible to prevent, personalty is slipping from under. The administration of the general property tax is everywhere attended with increasing difficulty, and in our large industrial

centres it has become, to use the words of a recent tax report, "a howling farce." Everywhere, north and south, east and west, although in varying degree, comes the cry that the attempt to enforce the general property tax, whether by listing bills or tax ferrets, by oaths or by inquisitors, is doing much to force upon the average citizen habits of falsehood and corruption.

Second, a growing lack of equality in tax burdens, not only as between classes in the community, but as between individuals of the same class. Where land, for instance, is assessed at 20 per cent of its value in certain counties, and at 80 per cent or 100 per cent in other counties, it is obvious that the contribution to the state tax is grossly unequal and unfair.

Third, the application to general purposes of what was intended to be only a local revenue. All direct taxation was originally local in character, and the assessment of property for local taxation was at the outset a comparatively simple matter. When the need for state revenues made itself felt, it was obviously expedient to tack on to this local taxation a quota for general purposes. But with the great development of state functions, and with the breakdown of the local barriers of commerce and industry, what was originally equal soon turned into inequality, and the attempt to fetter interlocal or even interstate business conditions by the bonds of purely local assessment has proved to be a fruitful source of difficulty.

Fourth, the failure to make modern corporations bear their fair share of taxation. The corporation is a growth of the last half century. It was unknown when the present framework of our tax system was established. The attempt to force the new wine into the old bottles is not only spoiling the wine, but cracking the bottles.

Fifth, the failure to secure adequate compensation from individuals and corporations alike for the franchises and privileges that are granted by the community. An earnest effort is being made at present throughout the length and breadth of the land to repair this defect. But with the historic system as it has come down to us in this country of estimating wealth in terms of property rather than, as abroad, in terms of income, we have been plunged into the vortex of the assessment of franchise values, and have thus been compelled to attack a problem which does not even exist in other parts of the world.

Sixth, the undue burden cast upon the farmer. Practically,

this is the problem of taxation in many of our rural districts and in all agricultural communities where the failure of an adequate revenue system and of the readjustment of social resources makes it impossible to secure good schools or fairly decent roads without overburdening what is, after all, the chief source of American prosperity.

Seventh, the interference with business, due to the partial and spasmodic enforcement of antiquated laws. Witness the attempt in some states suddenly to levy a mortgage tax, as recently in New York, where the entire building industry was thrown into confusion; or the attempt in other states to enforce now this and now that kind of property tax on businesses which led to a change in the location of the business rather than to any increase of revenue. The harassing of the individual business or the fear of harassment is becoming less and less defensible in the delicately adjusted mechanism of modern business society. Over a century ago Alexander Hamilton, in his famous report on manufactures, stated this golden maxim: "All taxes which proceed according to the amount of capital supposed to be employed in a business are inevitably hurtful to industry and are particularly inimical to the success of manufacturing industry and ought carefully to be avoided by a government which desires to promote it. It is in vain that the evil may be endeavored to be mitigated by leaving it, in the first instance, in the option of the party to be taxed to declare the amount of his capital or profits."

Eighth, the failure to make great wealth contribute its due share. In former times, where property was fairly equally distributed and conditions simple, inequalities in tax burdens were slight and unperceived. Before the huge aggregations of modern wealth, the crude tax machinery of earlier days stands impotent. And yet we hug ourselves with the delusion that all that is necessary is to patch up the old machinery, whereas what is really needed is to throw the old machinery on the scrap heap and to utilize entirely new and modern instruments and processes.

II. *The Meaning and Advantage of Separation*

We must recognize the fact, however, that revolutions of this kind occur but seldom. The only method of achieving substantial progress in society is, after all, by attempting to go forward step by step. But however slow the change, it is imperative

that the goal be kept clearly in mind if there is to be any progress at all. If we move step by step, it is highly important that each step be a forward, and not a retrograde, one. Now the starting point from which progress of all kinds must set out at the present time in the United States is, apart from the important administrative changes to be touched upon later, the abandonment of the use for state purposes of a locally raised and administered revenue. Whatever other reforms are needed, and they are many, no lasting progress can be made unless we take this preliminary step. It is for this reason that we have ventured to put in the foreground of discussion the problem of the separation of state and local revenues.

The utilization of the same sources for both purposes is, as we have seen, a natural development, at least in Anglo-Saxon communities where the spirit of self-government has always been strong, and where the local unit has been the cell that has grown through accretion into a mighty nation. Yet the employment of the identical sources of revenue for state and local purposes has not only helped to engender many of the difficulties which have been adverted to above, but has succeeded in confusing the issue, and in rendering exceedingly difficult a satisfactory solution of the problem. Where each local community finds that its interests are in some unaccountable way bound up with those of other communities, the tendency is to induce an unwillingness to experiment with any changes, no matter how necessary, which through the influence of these common interests may perhaps react disadvantageously upon the interests of the particular community. The result is the breeding of mutual suspicion and, what is still worse, of lethargy. Just as no single individual can be expected to submit an accurate list of his taxable property when he is sure that his neighbors are all successfully withholding their own, so no community will be willing to make any change in methods, the result of which would, in all probability, only be to increase its common burdens. The separation of state and local revenues is therefore a matter of importance in the American commonwealths of to-day, not so much because it forms in itself any solution of the problem, but because it is the indispensable initial step to any substantial and lasting progress. The separation of state and local revenues is not a cure, but it will help to make a cure possible. It is from this point of view that we must address ourselves to the problem.

There are four aspects of the subject: First, what is meant

by separation of state and local revenues? Second, what are its advantages? Third, what are the objections and possible dangers? And fourth, what has thus far been its history and development?

I. In the first place, separation denotes, as the word implies, some distinction between the classes of revenue. Almost everywhere in the United States the general property of individuals is assessed for local purposes; and as corporations developed, their property was also assessed in the same way by local assessors. County expenses are usually defrayed by apportioning the necessary amount to the localities according to the assessed valuation of property and thus adding a county rate to the local rate. Finally, the state expenditures are defrayed in precisely the same way by dividing up among the separate counties a sum proportioned to the assessed valuation in the counties. Thus the final tax rate upon property is made up by the addition of these various rates. But the assessment and the collection are for the most part in the hands of local authorities.

What will be gained by the separation of state and local revenue is that the state revenues will no longer be collected from the same source and in the same manner as the local revenues. It means practically that there will be no state tax rate on general property added to the local tax rate through the process of apportioning state expenditures among the localities according to the assessed valuation. It implies as a corollary that some other method of securing the state revenues be devised. The demand for separation is primarily a negative rather than a positive one; it is destructive rather than constructive. It leaves open for debate what particular alternative methods should be substituted. It proclaims in no uncertain tones, "Leave to the locality what properly belongs to the locality; allot to the state what properly belongs to the state."

II. The second aspect of the problem is a discussion of the advantages that would ensue from separation. These may be summed up under the following heads: *A*. Conformity with the natural division of government functions and activities. *B*. Greater equality in assessments. *C*. Lowering of the tax rates. *D*. Removal of conflicts between city and county. *E*. Greater flexibility and adaptation of means to end.

A. The first advantage is conformity with the natural division of government functions and activities. The relation of government to business life necessarily changes with the conditions of

business activity. When business was purely local in character, as was true in former times, the local authorities were competent to deal with it. To-day yet, activities connected with real estate are still largely of this character. The real estate cannot be removed from the locality, and the benefits and burdens attaching to real estate are still to a very large extent bound up with the people who live in the immediate neighborhood. What is true of real estate was originally true of almost all economic phenomena. But it is no longer true. The scope of the great industries connected with the transportation of wealth and the transmission of power or intelligence is obviously no longer local in character, and many of the ordinary corporations and businesses are stretching out with an activity that transcends all local bounds. While the central office must indeed be in some one locality, the scope and content of the activities are no longer local, and in the great majority of cases any attempt to estimate the economic capacity of the business or corporation to bear the tax burdens by the property existing in that locality would be woefully inaccurate. Not only would the local property often be in no proportion at all to the local sales, but even the local sales would not be any index of the relative profits or tax-paying ability. The insurance company (although situated with its head office in some one town) does business throughout the entire state; the railroad may have four tracks in a little country village which contributes practically nothing to the traffic; a bank may derive its profits in large measure from out-of-town business. Where the activity is primarily interlocal or state, the burden should be interlocal or state.

Not only, however, is there this natural division between state and local functions, but even where the phenomenon itself is purely local, experience has disclosed in some cases the great advantage of assessment by state rather than by local officials. Real estate, for instance, can far better be valued by officials of the neighborhood who are cognizant of the local conditions, even though experience has shown the great advantages of a centralized or state control over the local assessments in order to secure an interlocal equality. But the administration of a liquor-license law is apt to be far more effective if completely divorced from local influences. It is for such a reason, for instance, that the liquor-license tax is now levied in New York by state officials with a far greater degree of efficiency and therefore with a far greater resultant revenue, than was formerly the

case. So also certain taxes are more effective when resting on a broad than on a narrow basis of assessment. The inheritance tax, for example, is obviously unfit for a source of local revenue because the number of wealthy individuals who die in any one year in a single town or city is so unpredictable and oscillating that the revenue would be entirely too spasmodic. Broaden the base by taking in the whole state, and the amount of property passing by death from year to year will be found to fluctuate very little.

Thus, from the double point of view of historic changes in the scope of government functions and of the effectiveness of administration, a clear line can often be drawn between what is properly a state, and what is properly a local, source of revenue.

This consideration really carries one step farther a distinction which is found almost from the beginning of our national existence. At first, there was no line drawn between national and state sources of revenue, and in the critical years succeeding the Revolution the Union had to depend upon requisitions addressed to the separate states, to be raised by them in the same way as their own local revenues. With the collapse of this system was settled once and for all the principle of a separate and independent national revenue from sources, in part at least, distinct from those of state revenue. The whole domain of foreign commerce, which up to that time had been within the purview of the separate states, was now transferred to the nation, and the force of historical necessity has since then converted certain forms of internal taxation, which were still for a long time administered by the separate states, to the practically exclusive possession of the nation. The process is not indeed entirely complete, and we are even now debating whether certain forms of state taxation should not hereafter be relegated to the general government.[1] The point which it is desired here to emphasize, however, is that the principle has been settled. It is the same principle which is now applicable to the separation of revenues within the state. It was the financial collapse of the Confederacy which brought about the separation of national and state revenues. It is the practical collapse of our antiquated fiscal system within the states which is just beginning to bring about the separation of state and local revenues. The change in the economic conditions at the end of the eighteenth century was responsible for the one; the change in the economic conditions

[1] See *infra*, chapters xii. and xxi.

at the beginning of the twentieth century will be responsible for the other. Thus, the first advantage of the separation of state and local revenues is the fact that it is in harmony with an underlying principle of historical growth.

B. The second advantage is the securing of greater equality in assessments. The differences in assessed valuations in various sections of our states have everywhere become so glaring that the last few decades have seen in almost every case the creation of boards of equalization designed to remedy the acknowledged evil. It is equally notorious, however, that the remedy has been entirely inadequate and that the boards of equalization have been unable to accomplish what was expected of them. The inequalities go on almost unchecked, very largely for the reason that the members of the state boards have too imperfect a knowledge of the local conditions to admit of any successful revision of property valuations. The relegation of the general property tax to the localities will at once render unnecessary any equalization, for if the state revenues are secured in other ways, and if the general property of individuals, whether real estate or personalty, is not directly liable for state purposes, there will of course be no inducement for the local authorities to seek to lower the local valuations of property. For purely local purposes it makes no difference whether there is a low valuation with a high tax rate or a high valuation with a low tax rate; the result is precisely the same. With the separation of state and local revenues the individual landowner in one part of the state will no longer be casting envious glances at the landowners in other parts of the state, and this mad scramble for reduction of assessments will be checked. It will depend entirely upon the people in the community itself, and not upon those in other communities, whether the individual tax rate shall be high or low. It was not until after separation was achieved—and as it was thought, permanently—in 1906 in the state of New York that it became possible to raise the valuations of real estate in New York city from the old level of 60–70 per cent to the new level of 90–100 per cent.

It is sometimes claimed that the system of separation will not stop undervaluation of real estate because there is the same struggle between the separate towns in a county as between the separate counties in a state. The reply to this, however, is twofold. In the first place, the proportion of county to town expenses is apt to be smaller than the proportion of state to

county expenses, where the state expenses are still apportioned in the old manner. The relative influence of county expenditure on local valuations is therefore slighter. But secondly, even where this is not true, the objection can be eliminated by making the original assessors county officers, instead of village or town officers, as is now the case in over one-half of our states.[1]

C. This brings us to the third advantage, the political aspect of which is not slight. Where, as at present in some cases, the state taxes form no inconsiderable part of the whole, the tax rate upon the individual property owner is naturally augmented to this extent. Under a system of separation of state and local revenues, with a relegation of the property tax to the localities, the rate of the tax will naturally be lowered by the entire amount of the state revenue previously derived from this source. In the development of the system in New York, for instance, this argument had great weight with the legislators. The separation of state and local revenue means a reduction of direct taxation of property.

D. The fourth advantage is the removal of conflicts between city and county. The present situation in many of our states is really an outgrowth of point *B* mentioned above; namely, the inequality in the assessments of property. Many of the rural counties claim that since there is a far larger proportion of tangible and visible property within their borders than is the case in the larger cities, the property actually assessed in their case greatly transcends in its relative proportions the property assessed in the cities. There is, therefore, a frequent pressure upon boards of equalization to raise the total valuations in the cities and to compensate for this by reducing the valuations of the rural districts. In a state like New York, for instance, there was an almost annual contest marked by bitterness and asperity, leading in some cases to the threat on the part of the city of New York that an attempt would be made to create a separate state. The segregation of state and local revenues puts with one blow an end to all these sources

[1] The movement in favor of replacing local by county assessors has progressed to such an extent that in 1921 the assessments of property were made by county officials in twenty-five states, including all the Southern (except Delaware and Louisiana) and Southwestern states and twelve of the western states (California, Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Ohio, Oregon, Utah, Washington, and Wyoming).

of difficulty and friction. The large city as well as the small town, each is allowed to go its way in peace.

E. The final advantage is virtually a corollary of the one just discussed; namely, a greater flexibility and adaptation of means to end. If each locality is now, through the separation of state and local revenues, divorced from the others and is left to work out its fiscal salvation, to a certain extent at least, independently, it is obvious that each locality will be better able to adjust its fiscal system to its own particular fiscal needs. The conditions of a commercial metropolis are very different from those of a country hamlet, and what may be entirely appropriate in the second case may be found to be completely unworkable in the first. The slow steed and the fleet pacer work very ill together in harness: set each of them free to do what he can and the total result will be far more satisfactory for all concerned. Uniformity of fiscal methods is desirable only where there is a uniformity of economic conditions. If we allow the different localities to experiment, within certain broad lines, as to the fiscal methods best suited to their own prosperity, the result is ultimately bound to be an adaptation of fiscal practice to economic fact.

Thus from each of these five points of view the benefits which would accrue from a separation of state and local revenues are clear and undeniable. But so strong is the force of custom and prejudice, and so inadequate is the ordinary analysis made of the situation, that the movement has really only just begun in the United States.

III. *The Objections to Separation*

It may be inquired, however, in the third place, are there no objections to the system of separation or are there no dangers connected with it? [1] A candid consideration would compel

[1] The objections have been forcibly urged by Professor T. S. Adams in the *Addresses and Proceedings of the First Conference of the National Tax Association*, New York, 1908, pp. 515–527; and again in *Readjustments in Taxation* published by the *American Academy of Political and Social Science*, 1915, pp. 131–139; as well as by Professor C. J. Bullock in an article in the *Quarterly Journal of Economics*, vol. 24 (1910), p. 43, *et seq. Cf.*, however, *Addresses and Proceedings of the Fourth Conference of the National Tax Association*, 1911, p. 86.

For a later, more comprehensive and juster appreciation of the controversy, see Mabel Newcomer, *Separation of State and Local Revenues in the United States*, Columbia University Studies, vol. 76, no. 2 (whole no. 180), 1917.

an answer in the affirmative. A closer scrutiny will, however, result in the conclusion that the objections are exaggerated and that the dangers are at least remediable.

What are the objections and dangers? They may be summed up under three heads: a lack of suitable state revenues; a lack of elasticity; a lack of suitable local revenues. Let us consider these in turn.

It might be claimed by some states that if the general property tax is abandoned as a source of state revenue, there is nothing to put in its place. The experience of the more advanced states, however, shows the fallacy of this contention. Even where the ordinary business corporations have not assumed vast proportions, we find in all the states the existence of the great public-service corporations. Under a proper system of assessment, the tax on corporations of this kind, if reserved primarily for the state, would go far toward defraying all legitimate state expenses. The difficulty now is that in many of our states the greater part of the taxes on corporations go to the localities, where, as we shall see in a moment, they are not needed, and only a small part, if any, is assigned to the state. If we render to Cæsar what belongs to Cæsar, the tax on corporations will go primarily to the state. Another source of state revenue which is now spreading in this country, but which has by no means received the development of which it is susceptible, is the inheritance tax. In New York one-fifth of the state revenue was at one time secured from this source, and the same is true in many foreign countries. Owing to defects in the principle as well as in the administration of the law, the inheritance tax in many other states is very ineffective. But New York again has shown the way. Where corporation and inheritance taxes do not suffice, other sources of revenue stand ready at hand. There is no reason, as we have seen above, why the license taxes should be reserved exclusively for local purposes. In the Southern states the license or occupation taxes have for a long time gone, in part at least, to the state, although the whole Southern system is capable of much improvement in this and other respects. Here, again, in New York, it has been shown what can be done, and one-fifth of the state revenue came, before prohibition, from the liquor-license tax alone. In short, without going more in detail into this question, which is susceptible of a far larger treatment, it may be said that there is scarcely a state in this Union where,

under proper methods, adequate sources of state revenues could not be discovered and effectively employed.

But even if this were not the case, and if it turned out to be difficult to secure additional sources of state revenue, there is still left a simple and efficacious means of accomplishing all the advantages that can be derived from separation, without incurring the hazard of not finding sufficient state revenue. This method may be called the apportionment-by-expenditure or apportionment-by-revenue method.

The apportionment-by-expenditure or apportionment-by-revenue method may be described as follows: At present the state general property tax is distributed among the counties by apportioning the quota of each according to the assessed valuation of property. The apportionment-by-expenditure method as opposed to this apportionment-by-valuation method would distribute the amount to be raised for state purposes to each county on the basis of the expenditure in whole or in part or, what is the same thing, on the basis of the revenues collected to defray this expenditure within each county and all the taxing districts contained in the county. The advantages of this scheme are obvious.

First and foremost, it would permit each locality to raise its revenues as it chose within certain broad lines, as laid down by the general law. The apportionment being no longer according to the valuation of property in general, but according to expenditures or revenues, it would be immaterial to any section in the state how the local revenues of any other section were raised. The important point would be the extent of the revenue and not the manner of raising it.

It was mainly to secure at once local option in the selection of the subjects of taxation that the apportionment-by-expenditure method was urged by Mr. Lawson Purdy, several years ago.[1] This designation of local option is, however, not entirely

[1] "Local Option in Taxation," *Proceedings of the National Conference on Taxation, under the auspices of the National Civic Federation*, Buffalo, 1901, p. 123 *et seq.;* also separately published by the New York Tax Reform Association. In this paper, Mr. Purdy is perhaps unduly critical of the other method of securing separation of state and local revenue. The apportionment-by-expenditure scheme was first suggested in outline by Mr. Allen Ripley Foote in a paper on general tax reform, presented to the State Commerce Convention of New York, held at Utica in 1899, read by Mr. Purdy and published in *Public Policy*, vol. ii., Jan., 1900. The main features of the scheme are elaborated in another paper by Mr. Foote on "A State

happy in that it does not adequately describe the powers to be conferred upon local communities. Moreover, the term "local option" has become so intimately associated with the liquor problem that its utilization for taxation is apt to become confusing.

Secondly, even if the general property tax were retained for the basis of assessment by the localities, the apportionment-by-expenditure method would result in a more equitable distribution of the burden than is the case at present. For, as has been explained, it is notorious that assessments of personal property in the rural counties are almost inevitably higher when compared to actual values than is the case in the cities. On the other hand, expenditures or revenues correspond much more nearly to the actual taxable abilities of the communities. Hence, apportionment by expenditure would bring about a more equitable distribution of burdens than is the case at present. A careful computation that was made several years ago in New York when the board of equalization still apportioned the state tax shows that under this new system the counties which would pay more are either the rich counties which contain the most valuable land in the state, or the counties which received too high a percentage rating from the board of equalization.[1]

Thirdly, the apportionment-by-revenue method would tend to economy in both state and local government. Local extravagance would, to a slight degree at least, increase the proportion of the state burden, and state extravagance would be directly reflected in a higher charge on the localities.

Tax on Local Government Incomes proposed as a Practical Substitute for a State General Property Tax," in the *Proceedings of the Fifth Annual Conference of the National Tax Association*, Columbus, 1912, pp. 253–262.

Curiously enough a precedent for this method may be found in the territorial period of Iowa, three-quarters of a century ago. The first legislative assembly of Iowa in 1839 enacted a law providing that five per cent of the gross amount of taxes charged on the county assessment rolls should be set aside by the county commissioners as a debt due to the territory. This, however, led to dissatisfaction on the ground that since the territorial tax was levied on the gross tax receipts of the counties, it "was regulated entirely by the necessities of the respective counties," and was therefore not distributed "upon principles of exact justice to all." The method was accordingly abolished in 1841. See J. E. Brindley, *History of Taxation in Iowa*, 1911, i., pp. 7–9.

[1] The figures, prepared by the New York Tax Reform Association, are reprinted in *Proceedings of the First Annual Conference of the National Tax Association*, New York, 1908, pp. 509–512.

The fourth benefit is that the present state boards of equalization would be rendered entirely unnecessary, for the whole matter would be settled by a mere arithmetical computation which would leave no room either for favoritism or for unintentional injustice.

Finally, fifthly, since it would be necessary to have full figures of statistics and revenues of all counties and local divisions, we should secure at once a system of comparative local statistics which have hitherto been almost entirely wanting in most of the states, and the lack of which is a serious obstacle to fiscal form.

The chief objection to apportionment by expenditure or revenue is that it might tend to prevent desirable expenditures in the more progressive communities. The force of this objection is, however, not so great as it seems. For, in the first place, if the community is ready to subject itself to the burdens of a larger expenditure for desirable aims, it will scarcely be checked by the slight additional burden which would result from the increase of the state tax. For the local burden is always very much greater than the state burden. Moreover, by taking the average expenditure for a number of years previous to the annual assessment, the variations due to a special local improvement in any one year can be minimized. Secondly, entirely apart from these considerations, the force of the objection could be very largely attenuated by combining the apportionment-by-expenditure method with the system above described of an independent state revenue from other sources than property. If this were done, that is, if the greater part of state revenues were derived from independent taxes, and if only the necessary residuum were raised by the apportionment-by-expenditure method, the proportion falling to each locality would be so exceedingly slight as virtually to rob the objection of whatever strength it might be supposed to possess.

Finally, it might be contended that the apportionment-by-expenditure method is unjust to the poorer localities, because it would interfere with the present American method of school taxation.[1] School taxes are levied according to assessed valuation, but are frequently, to a certain extent at least, distributed back to the counties and localities by the state according to population, thus equalizing the opportunities of the richer and

[1] This objection is urged especially by Bullock, *op. cit.*, p. 447.

the poorer sections. The force of this objection, however, can be weakened by the simple expedient of exempting such school expenditures from the operation of the principle, just as they are now excepted from the ordinary methods of local finance. The theory of the apportionment-by-expenditure method would still remain intact, and its automatic features would work equally well, if certain expenditures only, instead of all expenditures, were selected. What these expenditures or revenues should be would be a matter of adjustment, which might differ in the various states.

It is interesting to observe that an attempt has recently been made to introduce the apportionment-by-expenditure method. According to the Oregon law of 1907, the system of apportioning taxes according to expenditures was to go into effect in 1912. In this scheme, however, there were two points deserving of special mention. The first is that the apportionment was to be made not according to all expenditures, but only according to some expenditures,—expenditures for roads and later those for interest on the debt, for courthouses and for fighting pestilence being deducted in each case. While something may be said, as we have seen, in defence of these exceptions, the case is quite different with the other point, namely, the adoption of the rule that the apportionment was to be made according to county expenses instead of according to the total expenses of all the localities within the county as well as of the county itself. This derogation from principle is difficult to justify. For in this way the apportionment-by-expenditure method is robbed of many of its advantages. It would have had the effect of penalizing the poorer agricultural counties, for the obvious reason that county government is of relatively less importance and absorbs a far smaller share of the total revenues in counties containing cities than in sparsely settled agricultural counties.[1] The law, however, was never put into operation. For in 1908 the dissatisfaction with the predetermined-valuation basis of the law of 1901 led to a lawsuit which resulted in the court declaring unconstitutional the variation from the ordinary apportionment through equalized assessments, and thus by implication making the projected apportionment-by-expenditure method illegal. Accordingly no attempt was made

[1] See an address by Tax Commissioner C. V. Galloway, "Taxation Developments in Oregon," in the *Proceedings of the Fifth Conference of the National Tax Association*, Columbus, 1912, p. 240.

to enforce it. The tax commissioner of Oregon, however, maintained, after a careful statistical comparison,[1] that the apportionment-by-expenditure method, properly applied, would yield results more uniform and more equitable than those achieved by the old system on which the state now again relies.

A few years later the tax commissioner of Connecticut was converted to the desirability of the principle,[2] and in 1911 submitted to his legislature a recommendation and a bill designed to carry it into effect.[3] In 1915 the reform was finally accomplished in the shape of the apportionment-by-revenue method. The criterion for the distribution of the state property tax was henceforth to be the proportion of receipts from all taxing districts in each town, as averaged for the last three fiscal years, to such total receipts from taxes in all the towns as similarly averaged.[4] The plan has worked since then to the satisfaction of all concerned.[5] It is not unlikely that the views of the Oregon and Connecticut officials may gradually find supporters in other states as well.

Thus we see that the contention that separation of state and local revenues is impossible in some states, because of a lack of adequate state revenues, is weakened, if not entirely overcome, by the adoption, in part at least, of the alternative method now finding its way to the front in some of our commonwealths. It must, however, not be supposed that the principle of separation of state and local revenue is conditioned by the acceptance of the apportionment-by-expenditure method. If this method should on the whole prove to be unwise or inexpedient, the separation of state and local revenue would not be affected thereby. The

[1] *Op. cit.*, p. 243.

[2] *Cf.* William H. Corbin, Tax Commissioner, *Increased Revenue. Address before the Farmers' Association of the General Assembly* (of Connecticut) *Wednesday morning, March 10th, 1909*, p. 10.

[3] *Cf.* Wm. H. Corbin, "Apportionment of State Taxes on the Basis of Local Revenue," in *Proceedings of the Fifth Conference of the Nationl Tax Association*, 1912, pp. 263–269.

[4] The receipts of each one include the amount which should have been received as specially exempt property had such property been taxed similarly to other property in the town.

[5] The tax-commissioner tells us that "the present law is a vast inprovement on the previous one. . . . A town with a low assessment valuation and a high tax rate is put on the same basis as the town with a high assessment valuation and a low tax rate. . . . An incentive for economy is offered to the towns. *Report of the Tax Commissioners of Connecticut for Biennial Period, 1919 and 1920*, 1920, p. 39.

separation of state and local revenue does not necessarily imply either complete local option or any specific method of apportionment. They do not stand or fall together.

The second possible objection to the scheme of separation is the lack of elasticity in state revenues. Whatever are the drawbacks of the general property tax for state purposes, it is undeniable that the system is a highly elastic one. When the state needs more revenue, it simply increases the tax rate; when it needs less revenue, it diminishes the tax rate. By abandoning the general property tax for state purposes, we therefore lose this elastic element in the system.

There are, however, three ways of reintroducing the elasticity which will be lost. In the first place, the elasticity lost by the abandonment of the general property tax for state purposes might be regained by introducing a varying rate in one of the other taxes. There is no necessary reason why the tax rate should always be the same from year to year. In the case of taxes on business or on corporations, indeed, it would be highly inadvisable to alter the rates from year to year as tending to unsettle business. But to other forms of taxation this objection would not apply.[1] England secures elasticity by varying the rate of the income tax from year to year. There is no reason why in the American states the rate on the inheritance tax should not be modified from time to time so as to secure a slightly greater or slightly smaller revenue. The change in the tax rate on inheritances cannot very well bring about a change in the death rate of the people whose property is inherited. Secondly, if the above scheme should not approve itself to the community, we might adopt the suggestion which was accepted by the New York Special Tax Commission of 1907, namely, that the state should accumulate a surplus which it would hold to meet any possible deficit, and that if the surplus exceeded a certain figure it should be automatically returned to the localities for the relief of local taxation. Thirdly, however, and better than either of the other plans, the most obvious and simple method is to utilize as the elastic feature the apportionment-by-expenditure method described in the preceding paragraphs. If any more money is needed in any one year, so much more can be apportioned to the counties.

[1] I am unable to share the fears of Professor Bullock in this respect, as expressed in the article cited above.

In one of these three ways elasticity could without much doubt be secured.

The third and final objection to the separation of state and local revenues is that the localities cannot afford to relinquish to the state any sources of revenue which they now possess. It is claimed, for instance, that many of the rural counties which now secure a large revenue from the tax on the property of the transportation companies which happen to traverse them cannot afford to lose this revenue.

We here come to a point which has been much neglected in the discussion of the subject; namely, an insufficient analysis of what is really implied in the separation of state and local revenues.

As I conceive it, there are really two kinds of separation which might be termed respectively the segregation of source and the division of yield. Segregation of source means that a different source of revenue should be utilized for state purposes from that which is used for local purposes. It is this which is meant when we say that the state should no longer derive its revenue from the general property tax. But there is an entirely different method of attaining the same result; namely, by the exclusive state assessment of certain sources of revenue coupled, however, with an apportionment of a part of the proceeds to the localities. For instance, the inheritance tax ought to be levied by the state and not by the locality; therefore there would be here a segregation of source in the assessment. There is, however, no reason why, after the tax has been collected, a part of the proceeds should not be apportioned to the localities, although not necessarily in accordance with the sums raised therein. As to the corporation tax the best plan would indeed be, as we have learned,[1] to have the state levy an independent tax on the corporation as a whole, but to reserve to the localities the tax on the corporate real estate (or in the case of railroads even only on the non-operative railroad property) with the further allocation to the locality, in case of need, of a portion of the state tax. The excise tax in New York was admirably administered by the state officials, yet one-half of the proceeds was returned to the localities. The division of yield of a tax is perfectly compatible with a segregation of the source

[1] *Supra*, chap. viii. In this way the edge would be taken off the objections raised by Professor Bullock and Professor Brindley that a revenue from corporations is needed for local purposes.

of a tax. The trouble with our present system is that we attempt to make a local assessment of all property and then add something for the state, thus producing all the evils of the actual situation. What should be done, and what is beginning to be done in some places, is to leave the property tax on individuals and if necessary the real estate tax on corporations entirely to the local divisions and to develop a system of taxation assessed in first instance by the state, but with an apportionment among the localities of so much of the proceeds as may be necessary. We must not confuse segregation of source with division of yield. If we establish a separate system of state taxes, that is, a tax levied and assessed in first instance by the state, and if we then find, as can easily be accomplished, that the revenue is more than adequate for state purposes, it will be a simple matter to arrange for a distribution of the overplus among the localities.

As stated earlier in this paper, the difficulty is not with the social income as a whole. There is in the community an abundance of wealth which has never been tapped. The difficulty lies in the present method of apportioning the burden. By raising local revenues primarily from those sources which exist in abundance in the localities, and which are by nature local in character, and by retaining for state assessment those taxes which have a wider economic basis, we can be just to all demands of both state and locality without imperilling the fiscal situation in either, and at the same time securing a freedom from all the difficulties that beset us at present. The separation of state and local revenues includes two distinct phases, the segregation of the source of revenue and the division of yield of the tax. The real principle is to reserve a direct taxation of property for the localities and to hand over to the state all the other important sources of revenue, dividing a part of the proceeds among the localities and possibly making up any part of the deficiency for the state through the system of apportionment by expenditure. In this way we may secure all the advantages of separation of state and local revenue, and yet avoid the dangers and pitfalls.

It will be seen from the above presentation that separation of state and local revenue is by no means identical with what is sometimes called local option in taxation—a term in itself unfortunate for reasons that have been mentioned above. Separation does, indeed, involve some measure of choice by the localities, and that is, in fact, one of its great advantages; but

local option may obviously be carried to an extreme. The liberty of taxation on the part of separate local communities must not be permitted to disrupt the general scheme of taxation, or to imperil business activities through a rivalry in the application of the taxing power. What has been so laboriously gained in state taxation through the intervention of the national authority, which prohibits the state taxation of interstate commerce, must not be lost in local taxation through the absence of state control. What the separation of state and local revenue seeks to accomplish is, as we shall see below, to make it possible for localities ultimately to exempt personal property from local taxation. So far as a flexibility of local revenue may render this possible, it is desirable to grant to the locality, at least to this extent, a latitude of exemption. But this is far from being synonymous with a general demand for complete local option. That is a proposition which deserves discussion on its own merits, and to which valid arguments may undoubtedly be opposed.[1] Let us not endanger the attainment of the principle of separation by confounding it with a far more radical system of complete local option.

Another widespread fallacy is the assumption that separation of state and local revenues is in some way opposed to the policy of centralization of fiscal administration, which is now proceeding apace in our American commonwealths with such admirable results.[2] As a matter of fact, there is no opposition at all between these programs. The separation of state and local revenues means practically that the central or state government should be given more powers in the original assessment of certain taxes. Under the primitive system, still in force in most of our states, all the taxes are assessed locally, with no supervision or interference on the part of the state authorities, save through

[1] *Cf.* the article by Professor Bullock, "Local Option in Taxation," in the *Proceedings of the Fifth Conference of the National Tax Association*, 1912, p. 271 *et seq.* Professor Bullock concedes that there is no necessary connection between local option and separation of state and local revenues.

[2] Neither Professor Adams nor Professor Bullock can be declared free from a share in this error, if we are to judge from the articles mentioned above on page 357, note 1. The same may be said of Professor Brindley, "The Problem of Tax Reform in Iowa," in *Addresses and Proceedings of the Fourth Conference of the National Tax Association*, 1911; pp. 155–156. Yet in the same breath while opposing segregation Professor Brindley advocates "the local taxation of local business and local property and the state taxation of business and property which is non-local in character"!

the ineffectual device of the state boards of equalization. Under the more modern system, first one and then another source of revenue is taken over by the state government and administered directly by it, instead of by the locality. This is the case with the railroad taxes in most of our states, with the corporation taxes in general in many of our states, and with the liquor licenses in some of our states. The same is true of the newer taxes the assessment of which has never been in the hands of the local authorities at all, like the inheritance tax and the New York stock exchange tax. In all these cases separation of state and local revenues means centralization of administration. The one goes hand in hand with the other.

So far as the general property tax, or even the tax on real estate, is concerned, it is undoubtedly true that considerable progress has been made in those states which have succeeded in securing an effective state control over local assessments. But the inherent defects of the general property tax as the chief source of public revenue are such that no complete cure can be hoped for through mere centralization of administration. Even were this not true, however, the relegation of the general property tax to the local divisions would not in any way conflict with the principle of effective central control over local assessments.[1] Separation of source is one thing; control of administration is quite another thing. The warmest advocates of a more efficient administration through centralization are not in any way precluded from lending their support to the policy of separation. Let us not confuse things so essentially disparate.

IV. *The History of Separation*

We come finally to the history of the separation of state and local revenues.

The separation of state and local revenues in the sense of a provision for independent state taxes was recommended as early as 1879 by the state assessors of New York. The recommendation was worked out by the tax commission of 1881, created for that purpose, and was renewed by the comptroller in 1886, in a special report on salaries, taxation and revenue. The suggestion was further elaborated by the revenue commission of

[1] In New Jersey, for instance, these two things have gone hand in hand. See J. M. Mathews, "Tax Administration in New Jersey," in *The Journal of Political Economy*, vol. 20 (1912), p. 736.

Illinois in 1886 and by the Maryland tax commission in 1888. From that time on, however, we find comparatively little attention paid to the project, until the present writer took the matter up during the next decade. With the new century the discussion became more active.[1]

In practice, moreover, some progress is to be noted. In many states a beginning had been made by securing for state purposes a supplementary revenue over and above that from the general property tax. But this partial achievement secured few of the advantages of real separation except possibly that of a moderate reduction in the tax rate. In a few states, as in West Virginia, during the past few years, more progress has been made by cutting down the state tax on general property to a minimum, and thus achieving what the tax-commissioner calls a "practical realization of separation." Again, in a few of the smaller eastern states, like New Jersey, Connecticut and Delaware, where the commonwealth expenses were relatively slight, it was found practicable to defray them almost entirely from taxes on corporations. In New Jersey, however, the school taxes are distributed by the state, 90% going back to the county where they are raised, 10% going to the state schools and to the poorer counties. Moreover, the railroad tax revenue so far as it is not reserved to the state is distributed according to county valuations. The chief example of separation has now for many decades been Pennsylvania, where the system, however, developed so gradually as never to attract much attention. In Pennsylvania real estate is not taxed at all for state purposes, nor is personal property, whether of individuals or of corporations taxed for local purposes. The state revenue is independent of the local revenue. Apart from Pennsylvania, New York was until recently the leading example of separation of state and local revenues, although from the local point of view the separation was not complete because corporations were, and still are, subject to the general property tax for local purposes. So far, however, as the chief point is concerned, namely, the abandonment of the general property tax for state purposes, New York for a time, in practice reached the separation of state and local revenues.

The creation of an additional and independent source of state

[1] *Cf.* D. C. Westenhaver, of Martinsburg, W. Va., *The Separation of State and Local Revenues.* A paper read at the *National Conference on Taxation, held in Buffalo,* May, 1901; and separately published.

revenue over and above that from the general property tax began in New York over a quarter of a century ago, but it was not until the early nineties that the author was fortunate enough in impressing upon the authorities the importance of a system of more complete separation. Ever since that time the process went slowly forward, until in 1906 the final step was taken and provision was made for securing the entire state revenue—between thirty and forty millions of dollars—from other sources than the general property tax. The separation, however, was not enforced by any specific law; it was simply the result of an annual legislative decision.[1]

Had conditions remained normal, it is not unlikely that the practice would have received permanent legal sanction. A few years, however, after separation had been introduced, there came an extraordinary and prodigious increase in the state debt which for some years had stood at a little under ten million dollars. The contemplated improvement of the Erie canal called for an outlay of over a hundred million dollars, and the new scheme of improved state highways, with contributions to the towns and counties, was made possible by an additional loan of fifty millions. It was this fact and not any extravagance in general expenditures, as has sometimes been claimed, that was responsible for the inadequacy of the customary revenues. For the ordinary revenues, exclusive of any direct tax, just about kept pace with the expenditures exclusive of those connected with the new canal and improved highway funds.[2] The interest and amortization charges on this new and huge debt had now to be met out of the annual appropriations, and the sudden increase

[1] The separation was never technically complete. Even from 1906 to 1911 an insignificant direct tax on property was levied to meet the expenses of the court stenographers. This tax varied from $218,000 in 1906 to $228,000 in 1911. It was and is, however, levied by judicial districts and the rate depends entirely upon the amount needed by that district. Except for the fact that the boundaries of these districts are not coterminous with county boundaries, the tax is the equivalent of a county tax. In most states, in fact, these expenses are paid by counties.

[2] This is clear from the following table:

	Receipts from other than the so-called Direct Tax	Expenditures, exclusive of the Canal and Highway Funds
1905	$23,813,959	$24,511,947
1911	34,401,611	34,129,638

Cf. Annual Report of the Comptroller of the State of New York, Albany, 1912, pp. 96 and 100.

of expenditure disarranged the whole fiscal scheme. This eventuality had been foreseen by the Special Tax Commission of 1907, of which the author was a member, and a plea had then been made for the provision for some elasticity in the budget. The plea, however, was unheeded because the danger seemed to be remote and because there still was a substantial surplus in the treasury. When, now, in 1911 the legislature was confronted by this fiscal emergency of largely increased expenditures for debt service, without any additional revenues to meet them, the simplest way out of the difficulty seemed to be a return to the so-called direct tax, based on the old apportionment according to assessed valuations of property. Accordingly in 1911, after the lapse of five years, the old system was again put into force, and a direct property tax of over six millions was imposed, increased in 1912 to meet the increased sinking fund requirements to over ten millions. In the same way, the lack of any provision for elasticity led Connecticut, which had abandoned the direct property tax for state purposes in 1890, to reintroduce it, although at a low rate, in 1911. The responsible factor, however, in Connecticut was not so much the appearance of a sudden emergency as the disinclination of the important interests affected to accede to any increase of the specific taxes.

On the other hand, what had for the time been accomplished by custom in New York and Connecticut was brought about by law in California in 1910–11. California had long suffered from the evils of the old system and had become restive. Largely under the inspiration of Professor Plehn, of the University of California, the state tax commission recommended the adoption of the policy of separation in its reports of 1905 and 1906. After an unsuccessful attempt in 1908, the plan was finally authorized by constitutional amendment in 1910 and put into force by the statute of 1911. According to the new California system the state now taxes all corporate franchises,[1] all banks (except on their real estate), and all so-called public utilities such as railroad, express, telegraph, telephone, gas and electric companies, the property of which used for operative purposes is withdrawn from local taxation. These new taxes, together with the inheritance tax and the poll tax were designed to meet all the state expenses and to render possible the abolition of the state general property tax. This result was actually accomplished in 1911 amid general satisfaction on the part of the localities as well as of the

[1] As to the meaning of "franchises" see *supra*, p. 226.

state government.[1] It is hoped that this will continue to be the case in the future. Whether this hope will be realized remains to be seen. Judging, however, from the experience of New York and Connecticut, there is grave danger that, unless the system is rounded out by some method designed to secure elasticity, separation will not have been permanently achieved. At all events, the example of California is important as indicating the trend of public opinion in the United States.

V. *The Outcome*

There remains a word to be said about the ultimate outcome of the process of which the separation of state and local revenue is only the first step. To discuss this as it deserves to be discussed would need a separate chapter. All that I shall here attempt is to give a faint indication of the probable development.

In a primitive democratic community, the simplest way to reach the taxable ability of the individual is, as we have seen,[2] through his property. The general property tax is a satisfactory index of relative taxable faculty because the property is homogeneous. To tax the individual and to tax the property of the individual is virtually the same thing. But in modern times property is no longer homogeneous. With the development of commerce and industry on a vast scale, property splits up into all sorts of forms and the old homogeneity disappears. It becomes practically impossible to reach all forms of property equally. But as soon as it becomes in practice, as is the case everywhere, an uneven tax, the social consequences of taxation make themselves felt. The taxation of certain kinds of property is no longer the taxation of the individual who owns the property. He may pay the tax, but he no longer bears the tax. The vast economic forces which affect the property relations of class to class make themselves felt. Some taxes are shifted onward to other classes, and are, perhaps, ultimately diffused throughout the community. Some taxes are shifted backward to the original owner and through the process of capitalization are discounted by the new purchaser of the property. Thus, while some taxes remain on the owner, others finally disappear

[1] *Cf.* the *Special Report on Taxation showing the first Effects of Separation on State, County and Municipal Revenue and Taxation.* Sacramento, 1911.

[2] *Supra*, chap. ii.

entirely as a burden through a process of diffusion or absorption. A tax on mortgages, as is now well understood, does not remain on the lender of the money, but is shifted to the borrower, and where the borrower is a building operator, it affects the dwellings and ultimately the rentals with various incidental consequences all the way along. A tax on city lands is not borne by the man who has purchased the land after the tax is imposed, because he makes allowance for the tax in the purchase price of the land. The same is true of the purchaser of corporate or government bonds. A tax on the stock-in-trade of a merchant or factory-owner, if predictable and applied to all the members of a class, results in an increased price of that commodity to the consumer. No constitutional provision can be of avail against the overpowering force of economic pressure. We may, like Cnut, order the waves to recede, but they will not recede. The constitutional provision in most of our states, that all property should be taxed alike, has outlived its usefulness. We cannot tax all property alike, because it is humanly impossible under modern conditions to reach all property alike; and if we do reach all property alike, the modern social effects of taxation are such that we should not be putting an equal burden upon the property owners because we should then be hitting the wrong man. Until we recognize the fact that under modern conditions to tax the property is not, in many cases, to reach the owner of the property, no solution of the problem can be attained.

The separation of state and local revenue is, therefore, of importance because it will allow every community to approach the problem in an unbiased way, and will enable it to select those classes of property which could profitably be relinquished. It means practically that those communities which choose to abandon the personal methods of taxation and to substitute an impersonal taxation may be permitted to do so.

From this point of view it is therefore quite correct to say that the importance of separation lies, so far as local communities are concerned, in the freedom of exemption rather than in the freedom of taxation. The paramount problem of American public finance at present is the taxation of personal property, and all careful thinkers are agreed that personalty cannot be successfully reached by the localities. Whatever the future may have in store as to the possibility of reaching personalty

through exclusive state taxes or by substitutes for the personal property tax or by federal taxes, the line of least resistance in the effort to get rid of the obnoxious tax on personalty is through the freedom that may be granted to certain localities to make experiments in this direction. The mere fact that freedom of exemption may go farther than this and possibly lead to the exemption of improvements as well, or the so-called local single tax, ought not to terrify us. As we have seen elsewhere [1] the exemption of improvements in local taxation is on the whole undesirable. But that is after all a matter of relatively minor importance compared with the iniquity of the present methods of the general property tax. The extent to which exemption ought to go, moreover, may well be regulated by state law, and thus the dangers of complete local option be avoided.[2] But there is surely no reason why certain localities should not, if they so choose, experiment with the exemption of personal property. Where the general property tax is utilized only for local purposes, it will be far easier to accomplish the result than where it is used also for state revenues. This conclusion is confirmed by the history of the reform in England. Had the local rates also been utilized for general state purposes it is not likely that personal property would have been so readily exempted in 1840. Separation of state and local revenue would put us in the position which has been attained by England for almost three-quarters of a century.

But if the separation of state and local revenues should lead to the local exemption of personal property, two questions that will naturally present themselves are: first, how will great wealth be made to bear its share; and second, how is the burden on the farmer to be lightened.

As to the first point, it may perhaps be queried whether a better way of reaching great wealth is not by curtailing the special privileges which so often make great wealth possible. Without, however, developing this point here, it may be affirmed that if we desire to reach the results rather than the sources of great wealth, a method stands ready at hand. By developing the inheritance tax we shall accomplish the advantages of a personal taxation without its drawbacks. Moreover the devel-

[1] *Supra*, pp. 93–95.

[1] So in Germany, under the laws of 1893–5 the local communities have a rather wide latitude, within broad lines laid down by state law, as to the choice of local revenues. *Cf. infra*, p. xvii, sec. iv.

opment of an income tax assessed by state officials according to a general scheme might be expected to work more successfully than the discredited personal property tax, administered by local officials. With the corporation tax, the inheritance tax and the income tax we shall go far toward reaching the main elements of modern fortunes. The difficulties here, indeed, arising from the conflicts of state jurisdiction are great, but not insuperable. They will be overcome either by the development of a system of interstate comity, or perhaps by a further application of the principle of division of yield, whereby the taxes will be assessed in first instance on a uniform basis by the federal government and then apportioned according to constitutional methods among the states.[1]

The second problem is that of the farmer. If the local tax is primarily on real estate, and if, as frequently happens, the conditions of production are such that the farmer is unable to shift the burden of the tax to the consumer, what can be done? Here a double avenue of escape is open. In the first place, many of the expenditures of local communities ought to be defrayed by the state government. Even now, in several of our commonwealths, state roads are being constructed throughout the local divisions because transportation is being recognized as affecting the interests of the whole state. But if certain roads ought to be state roads, and constructed at state expense, why should not certain schools be state schools and conducted at state expense? Education, like transportation, is more than a merely local matter.

In the second place, while the expenditure side may be cut down in this way, the revenue side may be augmented by an application of the principle of the division of yield whereby the overplus of certain taxes like the state excise tax or the corporation tax or the inheritance tax or even the possible state income tax of the future is distributed among the localities. Thus the burden on the local real estate will be decreased rather than augmented. Under the present system the farmer pays not only his own taxes, but in large part the taxes of the rich men of the rest of the state. Under the new system of separation of state and local revenue, carried to its logical conclusion, the farmer will pay less and get more; and what is true of the farmer is true of other classes. The tax burden will

[1] *Cf. infra*, chapters xii. and xxi.

be shifted from the individual to the economic phenomena themselves.

Let us remember, in conclusion, that the real meaning of the separation of revenues is the separation of state revenues from dependence on the local revenues. It does not mean the separation of local revenues from dependence on state revenues. Practically it means that state revenues should not be derived from a share in the locally assessed property tax: it does not mean that the localities should be prevented from securing a share of the state-assessed corporation, inheritance, income or other taxes. Separation of revenues is one thing; division of yield is another. The objective of separation is the liberation of the state from dependence on the vagaries and inefficiencies of local assessment of property.

The problems of taxation in the United States are becoming every year more complex. In order to solve them we must keep in mind the ultimate goal, and be prepared to take the first step. The ultimate goal is the accommodation of fiscal methods to our changed economic conditions. One of the first steps, at least, is the separation of state and local revenues.[1]

[1] The chief conclusions of this chapter are now confirmed in Mabel Newcomer's comprehensive study of this topic referred to *supra*, p. 357. Her investigation closes in the following words: "In the states when it has been introduced thus far it has been a mark of progress."

CHAPTER XII

THE RELATIONS OF STATE AND FEDERAL FINANCE[1]

THE existence of several concurrent or overlapping tax jurisdictions has always been a source of more or less difficulty. It is especially, however, in federal states that the problem assumes its most acute form, and it is primarily in recent years that the complications have been vastly increased by the new developments of economic life. The problem is not peculiar to the United States, for the relations of local and imperial finance have long agitated the minds and taxed the abilities of British statesmen; while in federal states like Germany, Switzerland, Canada and Australia we have, as in the United States, the three-fold complications of local, state and federal fiscal adjustments. The problems are, with slight variations, everywhere analogous.

In the United States it is only of late that the difficulties have presented themselves in full force. Local expenditures were at first of slight importance; state revenues were derived from tacking on an addition to the well-nigh sole source of local revenue—the general property tax; federal revenues were by constitutional arrangement and well-settled custom, restricted as a rule to import duties and to a few categories of internal-revenue taxation.

Of late years, however, a three-fold change has occurred. In the first place, the growing inadequacy of state and local revenues has led to the selection of new sources of income, some of which were also occasionally utilized by the federal government. Secondly, the vast economic changes, which have broken down state lines and made industry national, have disclosed to a great degree the inherent weaknesses of certain forms of state taxation, and have led to the demand for some method of national supervision or regulation in order to secure uniformity. In the third place, the well-nigh complete failure of the general

[1] This chapter was originally published in the *Addresses and Proceedings of the Third Conference of the International Tax Association*, Columbus, 1910.

property tax in state and local finance and the growing belief that large fortunes are evading their share of the public burdens have engendered a widespread demand for some more effective method of reaching the wealthier classes of the community. These three causes have conspired to bring the subject of the relations of state and federal finance to a focus, so that it is now in the forefront of popular interest.

It behooves us, therefore, to give careful attention to this topic, and to endeavor to ascertain whether there do not exist some underlying principles of widespread application which may serve as a guide to the legislator and the administrator.

Looking at the subject in its largest aspect, it may be stated that there are at least three general considerations which must be borne in mind, in the attempt to make a permanent choice of revenues for each of the competing tax jurisdictions. These are respectively the considerations of efficiency, of suitability and of adequacy. Let us take these up in turn.

I. *The Principles of Efficiency and Suitability*

The problem of efficiency in taxation is naturally of vital importance. No matter how well-intentioned a scheme may be, or how completely it may harmonize with the abstract principles of justice, if the tax does not work administratively, it is doomed to failure. It is clear that the effectiveness of different taxes depends upon the nature of the tax, as well as upon the character of the administration. A tax on land, for instance, is apt to be best administered by local authorities; for it is, after all, the local assessors who may be presumed to possess the most exact knowledge of the local conditions upon which the value of the land depends. State supervision may, indeed, be desirable for certain purposes, but into that question we do not propose here to enter. In the main, a locally administered land tax will be relatively efficient.

Other taxes are less obviously local in character or are less well fitted for local assessment because of administrative difficulties. A good example, for instance, is to be found in the liquor-license tax known in New York as the Excise Tax. When the assessment of the tax was transferred a few years ago from local to state officials, the effectiveness of the administration was so enhanced as vastly to increase the revenue. The administration was removed from local politics, but was not plunged into state politics. Centralization of administration

here, as in many other domains of political life, has been found to approve itself to the popular mind.

Just as the state administered revenues have been found in some cases to be superior to locally administered revenues, it may be expected that federally administered revenues will in some cases be superior to state administered revenues. For not only is the federal administration in some respects superior in efficiency to that of the state, but the very character of the tax may render effective supervision far easier in the one case than in the other. The administration of the income tax, for instance, would undoubtedly be far more effective in the hands of the federal government than in those of the state government because of the difficulty, as we shall see, of localizing and adequately controlling incomes. Other instances of this distinction between administrative efficiency and inefficiency might readily be multiplied.

The second consideration is that of suitability. Are there any sources of revenue which are naturally more suitable for utilization by one tax jurisdiction rather than another? This is really a problem as to the basis of taxation. Is the basis of a given tax wide or narrow? Obviously, in proportion as the basis of a tax is more and more extended, the argument in favor of its utilization by the broader tax jurisdiction becomes correspondingly strong. Thus, one of the principal reasons, in addition to that previously mentioned, why the tax on real estate is not employed by the central government, is because the basis is so narrow a one. It is chiefly because the tax on real estate is unsuitable for the general revenue system that it is everywhere becoming more and more relegated to the local jurisdictions. This tendency is universal throughout the civilized world, and the seeming counter tendencies which are illustrated by some of the proposals in the new British budget could easily be explained away for entirely different reasons. So far as the relations between state and federal finance, at all events, are concerned, there is no doubt that a tax on real estate is obviously unfitted for the federal government. We in the United States have had but three instances of such a tax, of an entirely ephemeral nature, and in the main so unsuccessful that its repetition is exceedingly doubtful.

While real estate, with its narrow basis, stands at one extreme of the scale, we find at the other extreme, with a very wide basis, articles of general consumption. The widest possible basis is

afforded by commodities of so-called mass consumption, like tobacco and spirituous beverages; and we accordingly find that in the United States, as everywhere else, taxes on these commodities are reserved for the use of the broadest tax jurisdiction. Almost without exception the American states have voluntarily refrained from utilizing this source of revenue because of the obvious unsuitableness of taxes on consumption for state purposes. The same is true to a still greater extent of customs duties, which are almost everywhere kept for national or federal use. So strongly were these conditions of suitability present in the minds of our forefathers, that the American Constitution not only expressly reserves the employment of import duties to the federal government, but provides in effect that the indirect taxes should be uniform throughout the country. It is clear that this desirable uniformity would be completely lost if the separate states were to arrogate to themselves this important source of revenue.

The problem of suitability, however, with its considerations of wide *versus* narrow basis, has become of special importance to us in connection with three great classes of revenue,—the corporation tax, the inheritance tax and the income tax. In each of these cases various reasons, as we shall see, have conspired to put them forward as desirable constituents of a federal tax system; but it is beyond question that one of the controlling factors in this demand is the proven unsuitability, from some essential points of view at least, of these taxes for state purposes. This is due, above all, to the existence of interstate complications and to the fact that the economic basis of each of these three taxes is a wide one, while the state administrative basis is a narrow one.

With reference to corporations, this statement scarcely needs any further proof. There are, indeed, still to be found many small businesses in corporate form supplying primarily local needs. But the striking characteristic of modern business life is the existence of corporations whose products are consumed throughout the country and whose very location, as in the case of the transportation companies, is interstate in character. From the economic point of view, interstate lines have been completely broken down, and the attempt to elaborate a successful system of state taxes on corporations has been frustrated in large measure by the existence of these interstate complications. It is well known, for instance, that the national tax on cor-

porations of 1909 was due almost exclusively to the endeavor to secure an adequate and uniform administrative supervision of corporations. As a purely fiscal measure, the new tax is open to almost every conceivable objection. It is, for instance, repugnant to the principles of accounting, because it deducts taxes before arriving at taxable net earnings, a proceeding as little justifiable as would be a state tax on corporations which deducted from the taxable basis the locally assessable taxes, or *vice versa*. It is repugnant to the principles of justice in taxation in that it provides for the deduction of sums payable as interest on bonded indebtedness. This practically means that the tax is a tax only on the stockholder and not on the bondholder. Why the man who invests $10,000 in railroad stock should pay taxes, and another, who invests $10,000 in bonds, should go scot-free, has never yet been shown. The old argument that the bond represents indebtedness, while the stock represents property, is, as we know,[1] of little economic weight. It is a legal and not an economic consideration. If the real intent of the tax was to reach the people who owned the property, there would be no justification in taxing only the class of property owners known as stockholders.

Finally, thirdly, even if the intent is to reach only the stockholders, the corporation tax is repugnant to sound principles of finance. For, as is familiar to all students, a special tax on a particular class of capital invested in corporations will lead to a so-called amortization of the tax; that is, the market value of the corporate shares will fall by an amount equivalent to the capitalized value of the tax, so that the future purchaser of corporate shares will have bought them free of the tax, discounting future taxes in the lower purchase price of the security. Thus the burden of the corporation tax will be borne by present stockholders, leaving future stockholders free.

From all these points of view, therefore, the federal corporation tax might be declared to be violative of sound economic and fiscal principles. Nevertheless, all these objections are beside the mark, because the real intent of the tax is not fiscal, but social or regulative. It was because of the failure of the states adequately to regulate interstate corporations that this tax was devised. As a revenue producer, or even as a fiscal measure, it must be pronounced inadequate; but as a regulative measure it is pregnant of the most far-reaching, beneficial results.

[1] *Supra*, pp. 106–107.

Whether a satisfactory scheme of regulating large corporations can be attained through a purely fiscal measure may well be doubted. But since taxation can be, and often has been, utilized for social and regulative purposes, it may be expected that the regulative side of the corporation tax will serve as an entering-wedge to a more effective system. Thus the national corporation tax is a natural, and in principle on the whole a not undesirable, consequence of existing interstate complications.

In the same way the demand for a federal inheritance tax is in large measure the result of interstate conflicts of tax jurisdiction. Anyone who has taken the trouble to follow with care the working of the inheritance tax in our foremost commonwealths will realize that, as a revenue producer, it would be far more successful were it not subject to the difficulties of interstate conflicts of tax jurisdiction. The fact that the English inheritance tax in 1909 yielded about twenty times as much as the New York inheritance tax cannot be explained simply by the difference in population or in the tax rate. It is in large measure due to the fact that the Englishman cannot evade the tax as can the New Yorker by transferring himself or his property to adjacent states, where no such tax exists. On the other hand, there have been in America frequent instances of double taxation, as in the well-known case of the estate of a man whose property happens to be situated in another state being taxed by each state in turn. Thus the state assessment of inheritances means now undertaxation and now overtaxation—the net result being glaring inequality. From this point of view a federal inheritance tax would be as superior to a state inheritance tax as the latter would be to a local inheritance tax.

The same considerations, but in an intensified form, apply to the income tax. If there is anything that may be considered a well-settled induction from experience, it is that an income tax is more and more unsuccessful as the basis of the tax becomes narrower. In former times a local income tax was fairly workable because incomes were chiefly local in their nature. In modern times, however, the income of the taxpayer, and especially the income of the large taxpayer, has very little to do with the locality in which he happens to live. Nay, more, incomes nowadays, through the working out of economic forces, have become national and international in character, and at all events have far transcended states lines. A man may live in one state and may secure his income partly from real estate holdings

situate in another state and partly from investments in securities of corporations whose earnings are derived in many other states. It is not easy for any local or state administration successfully to ascertain or adequately to control such income of its resident citizens. And unless some alternative method of reaching the income at the source is devised, it will be almost equally difficult for a state or a local community to control the income earned within its borders by non-residents. While these difficulties are indeed not insuperable, as has been shown by the recent experience of several of our commonwealths, it is obvious that they will not be present in the same degree if the income tax is levied by the national government. A federal income tax thus possesses advantages which are not shared by a state income tax.

It will be seen, therefore, that so far as concerns the question of suitability, resting on the existence of conflicts of tax jurisdiction, the arguments in favor of federal corporation, inheritance and income taxes are of considerable weight. It would, however, be rash to conclude that the argument is convincing; for there still remains the third point, adverted to above, without a careful consideration of which no final conclusion can be reached. We come, in other words, to the principle of adequacy in taxation.

II. *The Principle of Adequacy*

If we look at revenue measures from the point of view of adequacy, it will be seen that the problem assumes a different form. Let us apply it first to the income tax.

So far as considerations of revenue are concerned, it can scarcely be contested that the income tax is not needed for federal purposes.[1] Federal revenues in the past have in normal times been derived almost entirely from customs duties and internal indirect taxes. There is no reason why these sources should not suffice for the future. Without entering here upon the general question of the protective tariff, it may be confidently asserted that we can continue to secure a large and growing revenue from import duties, whether the principle of protection be upheld in its integrity or not. Either a revenue tariff with incidental protection, or a protective tariff with

[1] For a fuller treatment of this aspect of the question see Seligman, *The Income Tax*, 1914, pp. 631–658.

incidental revenue can be made to yield the desired income. And when we consider the immense population in the United States, it is beyond all question that even a simple system of indirect taxes will suffice to raise the remainder of the needed revenue. The internal revenue, exclusive of the income tax, yielded at the close of the Civil War almost $300,000,000 a year, and if we take into account the prodigious increase in wealth and in consumption during the forty years that have elapsed, it will be apparent that the internal revenue system of the United States might be made to yield to-day many hundred millions of dollars more than it actually does, without even approaching the number of taxes or the rate of taxation that existed during the Civil War. It seems reasonable to believe that the prospective expenditure of the United States may be readily supplied by import duties, together with a few internal revenue taxes.[1]

A national income tax, therefore, is not needed for revenue. The argument in its favor, however, is none the less strong. If not indeed for revenue, it is needed for justice. This is due to the complete breakdown of the general property tax in state and local finance. Under the existing state and local systems there is no doubt that we are unable to reach the possessors of large fortunes. The wealthy man stands from under, chiefly because the loop-holes in the general property tax have become so numerous that any adroit individual can avail himself of them. A federal income tax is justifiable on the score of equity under prevalent American conditions.

I would here, however, sound a note of warning. It must not be imagined that a federal income tax would at once work well. The experience of Germany and even of England must not lead us astray. We have neither the administrative machinery of Prussia nor the methods of doing business which are found in Great Britain. The lump-sum income tax of Prussia would be difficult in this country; the scheduled income tax of Great Britain would meet with almost as many difficulties here. It has taken England half a century to work out the problem of its income tax and to make it fairly successful; it would take us, perhaps, almost as long to make even a federal income tax a complete administrative success.

[1] Note to 9th edition. It must be remembered that this passage was written before the Great War. The change in the present situation is discussed in a subsequent chapter.

Thus those who hope for a fiscal or a social panacea in the federal income tax will probably be much disappointed. Moreover, if introduced into this country, it must be framed with the most extreme care and on lines far different from the measures of 1862 and 1894.

One final advantage of the federal income tax which must not be overlooked is that it would render far easier the struggle that is going on in our various states to amend or to abolish the iniquitous personal property tax. The taxation of intangible personalty has become a byword and a reproach to our American public life. All efforts to reform the system of the general property tax have thus far shattered against the rock of popular conviction that such wealth as consists of personal property ought not to be allowed to escape. If, now, we were to have a federal income tax, however unsuccessful it might be at first, it would take the wind out of the sails of these objectors; and the would-be reformers of the system of local and state taxation would no longer be met by the contention that personal property must be listed for taxation. For personal property would then be reached through the federal income tax. It is significant that in England personal property was entirely exempted from all local taxation in the very same decade that the existing national income tax was imposed.

Our conclusion would then be that, so far as the income tax is concerned, even though it be not needed for purposes of revenue, it is nevertheless a desirable adjunct to our scheme of federal taxation. It goes, of course, without saying, that, even apart from this question, the projected constitutional movement, legalizing the income tax, ought to prevail. For even if the income tax were not to constitute a part of our normal revenue system, it would be deplorable in the extreme if a mighty empire like the United States were unable to use this potent engine of revenue in time of need.

When, however, we come to consider the inheritance tax and the corporation tax, we find that the argument from the principle of adequacy is somewhat different. The income tax is not at present needed for state or local revenues, but the situation may before long become the same as in the case of the inheritance tax and the corporation tax. Every one who is familiar with the recent developments of tax reform in the American states knows that the tendency is clear. There is a movement toward the separation of state and local revenues, with a reserva-

tion of the real estate tax to the localities. On the reasons for this world-wide movement it is not necessary or proper here to enter,[1] but it is pertinent to call attention to the fact that the general property tax is coming more and more to be restricted to the localities, and that the state governments have in consequence been compelled to reach out for new and independent sources of revenue. These new sources of revenue have consisted primarily of the corporation tax and the inheritance tax, supplemented in a few cases like New York by some other forms of taxation. In some states this process has been entirely completed, and the general property tax is no longer employed for state purposes, to the great advantage of all concerned. If, now, the federal government would seize upon either, or, still worse, both the inheritance tax and corporation tax, this entire salutary movement would have to be reversed. The assumption by the federal government of what it does not need for fiscal purposes and of what is seriously needed by the state government would be a calamity of the first magnitude—a calamity the full significance of which can only be appreciated by those who, during the past few decades, have patiently watched and labored to help in bringing about the beginning of the great reform which is now apparent. The abandonment by the states of reliance on the aid afforded by the corporation tax and the inheritance tax is something that cannot be contemplated for a moment.

On the other hand, as we have seen, both the inheritance tax and the corporation tax, like the income tax, are really more fitted for federal administration. How, then, are we to escape these two horns of the dilemma? According to the principle of suitability, the inheritance, the corporation and the income taxes should be federal taxes; according to the principle of adequacy, the first two should be in whole and the third perhaps in in part state taxes.

III. *The Apportionment of Federal Revenues*

It is permissible, however, to suggest a method which will prevent us from being impaled on either of the two horns of the dilemma, and which may extricate us from the difficulty. Why is it not possible to secure all the ends of suitability by having the taxes administered by the federal government under general federal laws, and why is it not possible to secure all the ends

[1] *Cf. supra,* chap. xi.

of adequacy by having the proceeds apportioned in whole or in part to the various states? This is my solution of the difficulty: let the federal government assess the taxes, and let the state governments profit by the taxes.

This is by no means so new or revolutionary a suggestion as it may appear. It is found in some form or other in many countries, and in not a few of the American commonwealths. In England, for instance, the inheritance tax is assessed by the central government, but a part of the proceeds is allotted to the local government. The same is true of some other taxes in England. In Germany the proceeds of certain indirect taxes are divided between the federal and the state governments, and one of the important features in the budgetary scheme of Chancellor von Bülow was to have a federally administered inheritance tax, a part of the proceeds to go to the state.[1] In Canada it is well known that a large part of the provincial revenues is derived from the proceeds of taxes that are levied by the federal government. Other instances might readily be multiplied. In the United States also many of our separate commonwealths raise revenues which are apportioned to the local administrations. Even the federal government, as in the one famous instance of the distribution of the surplus in 1836, apportioned to the states the proceeds of federally assessed taxes. The question of the constitutionality of the scheme here suggested may be left to the lawyers. My own opinion, expressed with all due diffidence, is that a constitutional method can be devised. But my additional opinion, expressed without any diffidence, is that, if constitutional methods cannot be devised, the sooner a constitutional amendment is procured the better it will be. I can see no other avenue of escape from the difficulties that are looming up on all sides.

It may, indeed, be claimed that the difficulties connected with the conflicts of state jurisdiction can be overcome in another way,—namely, by interstate agreements based on considerations of interstate comity, whereby each state will obligate itself to refrain from levying more than its equitable and proper share of the tax. While this consummation would be exceedingly desirable, it may well be doubted whether it is at all feasible. American experience has, unfortunately, driven home the lesson that the separate commonwealths cannot be depended upon voluntarily to relinquish any weapons which may constitution-

[1] This plan was realised in 1920.

ally be employed in the struggle of local and sectional interests for economic advantage. Even if the majority of the states could be induced to enter into such a compact, the defection or refusal of a few states would be sufficient to defeat the whole scheme. In other federal states, like Germany, *e.g.* it has been found necessary to achieve the desirable uniformity by imposing it upon the states through national regulation. It is clear, however, that the American commonwealths would not brook such national interference, and that the accomplishment of the desired end would require a constitutional amendment which it would be well-nigh impossible to secure.

Moreover, even if such interstate uniformity could be reached in this way, it would at best apply only to the inheritance tax. It was because of its hope of effecting some such reform that many have expressed their strong preference for a state inheritance tax. But even the thoroughgoing acceptance of the principle of interstate comity would still fail to meet the problem involved in the corporation tax—the problem, *viz.*, of reaching the corporate earnings derived exclusively or in large measure from interstate business. When even the economic apportionment to each state of its proper share of revenue from such complex sources is so difficult a matter to accomplish, the problem of the fiscal adjustment of interstate difficulties by purely state administrative methods may be declared to be well-nigh insoluble.

Unless therefore all the states carry out in good faith the principle of interstate comity as applied to the inheritance tax, through which alone a system of state inheritance taxes can justify itself, we are forced back to the scheme suggested above as the sole practicable alternative.

This method of federal administration and state apportionment will accomplish everything that is needed. It will conform to the principles of efficiency and of suitability, because the taxes in question can best be administered by the federal government and because in that way alone the gross inequalities of the present system can be overcome; while on the other hand the separate states will secure the revenue which they need, and will be able to continue in the path of tax reform which has been so auspiciously entered upon.

Thus we reach the conclusion that, of the three great taxes about which the controversy has now become so acute, the income tax ought to be levied by the federal government and its proceeds utilized to diminish the burden of the national indirect

taxes, with the possibility of the states tacking on additions for their own purposes or for local needs; that the corporation tax should be levied as a national tax by the federal government, but under a clear understanding with the separate states that the proceeds should be distributed, in whole or in greater part, to them; and that the same method should be applied to the inheritance tax, unless the states see fit to adopt, in essence, the principle of interstate comity. To determine the exact methods of repartition would be comparatively easy. For that would be a matter of detail, not of principle. The important point is that some adjustment be reached whereby the legitimate demands of equality and of uniformity may be complied with without those of efficiency and adequacy being sacrificed. The interests of the states must at all costs be safeguarded, but the difficulties inherent in a state administration of what has become national in character must be avoided. The plan outlined above will accomplish this end. In this way and in this way alone can we do justice to the underlying principles of fiscal and social reform. In this way and in this way alone can the relations of state and federal finance be put on an enduring and a completely satisfactory basis.[1]

[1] Note to 9th ed. (1921). In the decade that has elapsed since this chapter was originally written the outstanding fact is the fiscal revolution caused by the Great War. The general principles elaborated above are, however, still applicable to-day. For a fuller and more up-to-date discussion see *infra*, chapter xxi on "The Relations of Federal, State and Local Revenues."

CHAPTER XIII

THE IMPORTANCE OF PRECISION IN ASSESSMENTS [1]

I. *Democracy and Administration*

EVER since the days of Adam Smith, the demand for certainty has been one of the cardinal rules in taxation. Adam Smith borrowed his rule from one of the French writers. The arbitrariness of the French system of taxation in the eighteenth century had assumed such proportions as already to pass beyond belief, and it is no wonder that the would-be fiscal reformers raised a loud note of protest against the utter lack of certainty and precision in the French system.

It was not until the French Revolution that the worst evils of the system were swept away; but so fresh has been the recollection of these particular evils that from that day down to the very present, the whole system of French taxation has been so framed as to secure, even at the cost of certain other advantages, the ends of certainty and precision in assessment.

The danger of arbitrariness in assessment can be well illustrated in almost any absolute government. History is replete with examples that may be taken from any Oriental monarchy, and from imperial Rome. Many instances of the most shocking character might easily be taken from the existing absolute governments of the present. But absolutism is, unfortunately, not the only home of arbitrariness in taxation. Strange to say, democracy no less than absolutism is almost equally exposed to this danger. The danger, indeed, assumes a slightly different form. In absolutism there is a lack of law and of constitutional restrictions; in a democracy, like that of the United States, for example, which is the classic home of constitutional limitations, the danger lurks not in the law, but in the administration of the law; or rather, the law, which on its face seems to provide all

[1] This chapter was originally published in the *Addresses and Proceedings of the Second Conference of the International Tax Conference*, Columbus, 1909.

the constitutional guarantees of fairness and equality, breaks down more or less completely when exposed to the test of practical application under conditions for which it was not originally framed.

It is well known that in a democracy the difficulties of government are primarily administrative rather than constitutional. Our constitutional problems have been, in very large part, satisfactorily solved; our administrative problems have scarcely been attacked. The weakness of democratic administration is proverbial,—and this is especially true in the case of fiscal administration.

Our tax officials are almost uniformly elective officials, and it is a notorious fact that elective officers are but slightly immune from the gusts and passions of popular approval or prejudice. Nothing comes closer to the modern citizen than the amount of sacrifice which he is called upon to make in the way of contributions to the public support, and nowhere is there to be found a greater pressure, whether of individuals or of classes upon the government official than in the case of assessments for taxation. The abuses which in absolutisms are due to the unchecked will of the absolute ruler are found duplicated in democracies, owing to the dependence of the official upon the electorate.

This shortcoming of democratic administration is intensified by the inherent difficulties of modern economic life. In the complex industrial society of the present, with its delicate machinery and its subtle interrelations of all kinds, there is needed a far finer instrument of assessment than in former times. What is perfectly adequate for a primitive community, or a simple agricultural state, becomes glaringly insufficient in the modern industrial environment. Not only are the things themselves to be taxed increasingly difficult of location and appraisement, but the persons upon whom the assessment is levied become, under modern economic conditions, more and more elusive. And yet, just at a time when a more delicate and perfect machinery of assessment is required, a modern democracy contents itself with a clumsy and outlived mechanism, which is bound to give dissatisfaction.

Here in the new world we suffer from an accumulation of evils. Not only is this the home of the greatest experiment in democracy that has ever been attempted, but it is also fast becoming the home of the greatest industrial differentiation

and complexity of social and economic organization. Either cause alone would suffice to create difficulties in tax assessments; combined, they form an almost insuperable barrier to success. Mankind has yet to learn the lesson of combining, in fiscal matters at least, the great principles of liberty and efficiency. It is given to but a few countries to attain the administrative efficiency which is found, for instance, in the Prussian government. But that administrative efficiency is purchased at a cost of interference with individual liberty, which would, in this country at least, be considered entirely intolerable. Bureaucracy is not democracy. If, therefore, we eliminate the bureaucratic administration as inapplicable to American conditions, we are still confronted by this question: Which is better, the attempt to posit an ideal in taxation which shall seek to realize the principle of equal justice, even though we know that the endeavor to realize this ideal in practice will inevitably be marred by arbitrariness in administration; or, on the other hand, the readiness to frame a less ideal scheme with the knowledge that in practice it would be attended with greater precision and certainty of operation?

Put in this way, the answer can scarcely be doubtful. What statesmanship is trying to accomplish is not to pose abstract principles, but to accomplish advantageous results. And while the province of the scientist is indeed in part to elucidate fundamental principles, the publicist who is not to remain a mere closet philosopher must always narrowly watch the working out of his abstract principles amid the hard facts of daily life. Especially true is this of the science of finance, where the border line between finance and administration is scarcely distinguishable. An ideal principle which is administratively unworkable is not for an instant to be compared with a less elevated ideal which can be actually carried out in practice. The chief trouble with our American democracy in matters of taxation has been that the people have blindly clung to an ideal which has become administratively impracticable; and that they continue to hope against hope in expecting the impossible to happen. Our administrative methods are indeed slowly improving, but it will be a long time before that point of administrative excellence has been reached which will render possible the realization of the fiscal ideal. In the meantime, the disparity between the ideal and the practice is such as to create in our modern democracy some of the very worst evils

of tax assessment which are common in countries without any tax ideals at all.

I do not hesitate to assert that at the present time, in the United States, the chief evils in public finance are to be found primarily in that lack of certainty and precision which were so vehemently emphasized by Adam Smith a century and a half ago. In fact, if we take a broad view of the modern development of taxation, we shall find that one, at least, of the reasons for the great extension of indirect taxation throughout the world is to be found in the fact that here, at least, under the improved modern systems, we are able to attain a certainty and a definiteness which is lacking in the other domains of public revenue. The problem is on a large scale what the choice between *ad valorem* and specific duties is on a small scale. From the point of view of abstract justice there is no doubt that *ad valorem* duties are in the main more equitable, and yet sad experience has taught many a modern nation that there is in *ad valorem* duties such an inherent danger of arbitrariness of administration that they have, perforce, taken refuge, to a very large extent, in a system of specific duties, which is administratively workable, and which contains increased guarantees of certainty and precision.

II. *American Conditions*

The chief examples of the evils of arbitrary assessments in the United States at present are found in three classes of taxation: the tax on real estate, the tax on personal property and the tax on corporations. Let us say a word as to each.

In the case of real estate, the evils are comparatively insignificant, owing to the fact that real estate is visible and tangible, and that the impediments upon the transfer of real estate have been so far removed in this country as to make real estate almost as easily salable as personal property. Naturally where sales frequently occur, the selling value becomes a matter either of record or of common knowledge.

Notwithstanding this fact, experience has shown—especially in our larger cities—that the assessment of real estate is very largely arbitrary in character. In some cases the land is held on long leases and sales are infrequent. In other cases a false purchase price is put in the deed, and in still other cases there are sudden changes, either up or down, in the value of the real estate, due to more or less unpredictable changes in busi-

ness prosperity, in the opening up of new means of communication or in the tides of fashion. As a consequence the true value of real estate becomes a matter of very expert knowledge; and as our tax departments are notoriously unable to secure the services of high-paid experts, the assessment is very largely left in the hands of more or less incompetent underlings. The result has been a system of haphazard assessment, which even with the best intentions, and with all absence of corrupt motive, has meant a decided inequality as between individuals. Where, as frequently occurs, separate parcels within the same city or ward are assessed at all the way from sixty to ninety per cent of their real value, we cannot speak of precision or equality in assessment.

A way out of this difficulty has been indicated by the adoption, in part at least, of certain mathematical rules to guide the assessor. Such schemes have been applied by Mr. Somers, formerly of St. Paul and by the Board of Taxes and Assessments in New York City. Without going into the details here, it may be said that the system consists in applying known, instead of unknown, factors to the problem, and in seeking to remove, as far as possible, the arbitrary guess of the assessor. Of course it must not be forgotten that the opportunity for the introduction of mathematical rules in the assessment of real estate is only a limited one, for at the bottom the basic values which are to be multiplied by this mathematical factor must largely remain a matter of individual judgment. In the last instance we cannot get away from the expert decision as to fundamental valuations; but to the extent that known are substituted for unknown factors, a decided improvement is possible, even in the case of real estate.

It is, however, in the case of personal property that the evils of discretionary opinion become far more flagrant. There is no need to repeat here the familar story of the breakdown of the general property tax; of the failure to ascertain the existence of many kinds of property, and of the shocking inequality of assessment, even where certain kinds of property are discovered. The adoption of mathematical rules of assessment will, of course, not help a whit in those cases where it is impossible to discover anything to be assessed. But in those instances where certain kinds of property are on the assessor's books there is room for considerable improvement by the adoption of more precise and definite rules.

As a good example of what I mean by this statement, take the case of the mortgage tax. The assessment of mortgages as a part of the general property tax has everywhere become notoriously ineffective. The recent adoption of the recording mortgage tax, as in the state of New York, where all mortgages are, so to say, automatically subjected to taxation at the moment of their creation, has brought about, among many other benefits, not only equality as between mortgages, but a decidedly increased revenue to the treasury.

Of a character similar to this is the substitution in some of the Canadian cities of the so-called business tax or rentals tax, or the recent adoption in one of the Australian states of the so-called "abilities" tax, in lieu of the personal property tax. The imposition of a definite percentage upon the known rentals affords a simple and precise method of reaching property which otherwise would very largely escape notice altogether.

Those who are familiar with the French system of taxation will remember that it is built up entirely on the idea of substituting known for unknown factors, and that while the system has certain disadvantages of its own, in so far as it does not attain the ideal of precise approximation to the exact conditions of the individual, it possesses at all events the advantage of avoiding the haphazard guesses and arbitrary estimates which are almost inseparable from any democratic administration of personal or individual valuations.

It is, however, in the case of the corporation tax that the problem has become most acute in this country. The well-nigh universal system of taxing corporations is through the medium of the assessment of the corporate property. In some states, as even in the great state of New York, for example, the local tax of corporations which, as almost everywhere, is the one of most importance, is based upon the valuation of the corporate property by local officials. Under this system the most absolute arbitrary discriminations are made, as between the various localities, and it is a notorious fact that those corporations where it is physically possible to do so will often transfer their ostensible chief office from one place to another, in order to secure a more complaisant assessor. In other states, especially for certain classes of public service corporations, the valuation has been put into hands of a state board, which obviates indeed these glaring discrepancies as between localities, but which does not give any increased as-

surance of exactness or precision. Even in such cases the abuses are frequent. And what is worst of all, the secrecy observed by the state board of assessors renders it utterly impossible for either the victim or the scientific observer to point out the error in the procedure. Especially true is this in all those cases where it has become customary to assess the value of the franchises of corporations, a system which is obviously peculiar to our country, and from which all the European states which base the assessment on income, rather than property value, are entirely exempt. Valuations of our state boards of taxation are so notoriously inadequate that in the case of one class of corporations, namely, railroads, the cry has now gone forth for an official national valuation. Without going into the arguments for and against this scheme, it need only be pointed out that the successful prosecution of this idea will not only cost tens of millions of dollars, but will take a very long time to effect; and that the attempt to apply this same method of national official valuation to all corporations that are subject to taxation would not only be hopelessly expensive, but would, for obvious reasons, be entirely impracticable. In the great mass of cases, if we are to have any valuation of property at all, we shall have to content ourselves with the perpetuation of the present most unsatisfactory methods. The experiences that we have had, even with the so-called official valuations of railways in Michigan and Wisconsin, are not such as to warrant the confident expectation that they are satisfactory for tax purposes, and that they avoid the evils of arbitrary assessment.[1]

How much better it is to take some external criterion, as is now the practice in a few of our advanced states. In the case of public service corporations a definite percentage of receipts is an obviously simple method. This is not the place to discuss the pros and the contras of a tax on gross receipts *versus* a tax on net receipts; but it may be pointed out that so far as railroads, at all events, are concerned, under the new system of accounting which has been enforced by federal law, the chief objection formerly urged against the tax on net receipts loses much of its potency. But whether we have a tax on net receipts or a tax on gross receipts, it is undeniable that the tax is precise and definite; that there is no room for secrecy or arbitrary action, and that equality as between classes of

[1] *Cf. supra*, pp. 230, 231.

corporations or between individuals in a class, may be secured by the adoption of precise mathematical rules which will cause the rate to vary in accordance with the definite and easily ascertainable factors.

It is true indeed that a few cases have recently been seen of state legislatures abandoning the receipts tax for the system of valuation, but I think that I am safe in saying that expert opinion is almost unanimous in this country that this was a step backward and not a step forward; and that all the ends which it was attempted to secure by the reintroduction of the valuation system might have been secured by a modification of the rates and methods of the old system. Any method of corporate taxation, in short, which is based upon the application of precise and definite rules, is preferable to the happy-go-lucky system of property valuation, whether it be a tax on gross receipts or on net receipts; whether it be a tax on a certain proportion of the market value of the stocks or of the bonds, or of both together; whether it takes some other exterior criterion of the business: any of these methods is susceptible of a more or less successful application because it avoids the fundamental evil in our present system. No one man or set of men is able to value intelligently and precisely the selling value of the multiplicity of corporations in our modern industrial world, with the continual oscillation of business, and with the increasing complexity of industrial interrelations. The task is one for superhuman strength and ability, and with the weakness of our democratic administrative methods, the attempt would be ludicrous, if it were not so lamentable. The first step in the reform of methods of assessment is, as far as possible, to substitute the known for the unknown.

What the future has in store for us it is given to no man to know. Popular customs and prejudices yield only slowly. The thick mist of ignorance and inertia can be dispelled only very gradually by the sunlight of knowledge and observation. But if the experience of mankind is to afford us any help in fiscal matters, and if the history of other countries under somewhat similar conditions is to be of any aid to us, it may be stated with some reasonable degrees of confidence that advance in tax reform is to be sought rather in the progressive excellence of administrative methods than in the elaboration of new and high-sounding ideals. The ideals may be the same for all countries; the administrative methods must differ according to the pe-

culiarities of each. In our American adherence to an abstract ideal we have failed to let our administrative methods keep pace with the attempted realization of the ideal. In our endeavor to secure the taxation of all property, we have not only attempted the impossible, but we have opened wide the door to all the abuses of practical inequality of unintentional injustice and of widespread arbitrariness.

Of all the methods that cry out most loudly for reform, that of property valuation is the most important. The great need of the day is to replace arbitrariness by certainty, and to secure practical equality in taxation by substituting, as far as possible, definite and fixed rules of assessment for the hodgepodge and capricious system, or lack of system, which is well-nigh universal to-day.

CHAPTER XIV

THE CLASSIFICATION OF PUBLIC REVENUES

AMONG the unsettled questions of the science of finance few are more troublesome than that of classifying the different kinds of public income. Classification is indeed not of supreme importance, for matter is always more essential than form. But correct classification is helpful in many ways. It requires logical criticism and rigorous analysis, and thus becomes a test of mental vigor; it conduces to accurate definition and prevents looseness of expression and confusion of thought; it may have important practical results in deciding questions of fact and in assigning definite values to doubtful categories; it points out contrasts and resemblances, and by eliminating or combining what is common, often suggests a clearer conception of the subject-matter. Correct classification is, in truth, an essential condition of all scientific progress.

It has frequently been remarked that we must distinguish between historical and actual classifications. For example, the whole class of lucrative prerogatives—the *Regalia* of the Teutonic kingdoms and of early fiscal science—were formerly separated from the other categories of public revenues because of their commanding importance in mediæval countries and of their supposed points of difference; whereas well-nigh every recent writer of importance, even in Germany, has confessed that all such revenues are capable of being classified under one of the other modern categories. So, again, while the revenue from the incidents of feudal tenure played a great rôle in the classification of Blackstone and other early writers, the need of showing the composite nature of such revenues has been obviated by the disappearance of the tenures themselves. Finally, special assessments are a growth of comparatively recent times. Only a short time ago, a classification of public revenues might safely have ignored their existence; now a logical classification of actual revenues would be incomplete without them. What concerns us here is a classification applicable to modern conditions.

I. *The Primary Classification*

From the standpoint of the individual all contributions to government are either gratuitous, contractual or compulsory. Every governmental revenue must fall within one of these three great classes. Individuals may make the government a free gift, they may agree or contract to pay, or they may be compelled to pay. The first method of securing revenue was at one time important, but its influence to-day is slight. The second and third methods correspond to the widely adopted classification suggested by Adam Smith,[1] who tells us that:

> "The revenue which must defray . . . the necessary expenses of government may be drawn either, first, from some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people, or, secondly, from the revenue of the people."

That is, the government may in the first place act like a private individual, possessing lands or other revenue-yielding property, and engaging in mercantile, financial or industrial pursuits. As Petty, the author of the first systematic English treatise on taxation, put it in the seventeenth century, the state is in some places the common cashier, the common usurer, the common insurer or the common beggar.[2] This is what the French call in the widest sense the revenue from the private and industrial domain of the state, and what the Germans term the private-economic income. A better term, perhaps, is contractual income; since the government here puts itself in the position of a private person making a contract with another person. Such payments all rest on an agreement between the two contracting parties, in sharp contrast to the payments which the government demands by virtue of the sovereign powers delegated to it.

We often hear of the distinction between voluntary and compulsory contributions, meaning by the former the free gifts of the citizens. This distinction, however, is not perfectly accurate; for contractual contributions are also voluntary, without being gifts. In the case of a contract, the government agrees to do some particular thing in return for a payment,

[1] *Wealth of Nations*, book v., chap. ii.

[2] William Petty, *A Treatise of Taxes and Contributions*, London, 1667, pp. 60, 61.

leasing land, for instance, in return for rent; in the case of the free gift, the government does not undertake, nor does the donor expect, any specific action in return. Yet both payments are voluntary. We must therefore distinguish not merely between voluntary and compulsory contributions, but between gratuitous, contractual and compulsory contributions.

Thus far almost all writers are agreed. The difficulty arises when we desire to classify the various kinds of compulsory revenues and to distinguish between some of these subdivisions and the different kinds of contractual revenues. All possible combinations have been made, especially by recent German writers. Let us confine ourselves in this chapter to the pith of the controversy, namely, to the subdivision of the compulsory contributions and their relation to some of the contractual revenues, as, for instance, the charges made for the services of governmental enterprises, like the postoffice, the telegraph and the like.

In taking the property of individuals the sovereignty of the modern state manifests itself in different ways. The government may exercise in turn the power of eminent domain, the penal power, the police power or the taxing power.

The power of eminent domain confers on the government the right of taking at its discretion, and to an indefinite extent, private property for particular uses. With the constitutional and moral limitations upon this power we have not here to deal, chiefly because the power is for the most part not a source of net revenue. The fact that in all free governments private property cannot be taken under this power except for public use, and even then not without just compensation, would in itself show that no net income to the state is contemplated. Yet such revenue may accrue incidentally; for the benefits accruing to the government through the expropriation may conceivably be greater than the damage inflicted on the private individual. Revenue through expropriation is thus the first class of compulsory income.

The second sovereign power of fiscal importance is the penal power, or right of inflicting fines and penalties, known technically as the power of sanction. This might be declared a part of the police, or regulative, power of the state, since every government regulation must carry with it the power of enforcement. But on account of the decidedly problematic fiscal importance of the police power, it seems better to separate them.

The power to adjudge fines and penalties, however, while often quite important as a source of revenue, belongs rather to penology and administration than to the science of finance; for the private property is here taken, not in accordance with the needs of the state or with any principles of equality or uniformity or benefits or compensation, but solely as a punishment inflicted on the individual. The only limit to its fiscal significance in free countries is the vague provision, as in the constitution of the United States, that excessive fines shall not be imposed or cruel and unusual punishments inflicted. Fines and penalties thus form by themselves a class of compulsory revenues levied according to definite but non-fiscal principles. It is obviously wrong to class them with fees, as do some writers, or to ignore them entirely, as do others.

The third sovereign power of the state is the police power, or the power of regulation. This has played a great rôle in American jurisprudence. Yet it may be confidently stated that from the standpoint of the science of finance the distinction drawn between the police power and the taxing power is to a great extent a fiction, referable to certain difficulties in American constitutional law and to a lack of economic analysis on the part of the judges. Let us study this point more in detail.

II. *The Police Power versus the Taxing Power*

The commonly accepted distinction between these powers is that the former is for regulation and the latter for revenue. One argument in support of this view is that advanced by authors like Mr. David A. Wells, who contend that a so-called tax which looks to anything besides the securing of revenue is not a tax, but an unconstitutional exercise of the taxing power. But even adherents to the distinction between the police power and the taxing power, like Judge Cooley, confess "that, in the apportionment of taxes, other considerations than those which regard the production of a revenue are admissible, and that the right of any sovereignty to look beyond the immediate purpose to the general effect cannot be disputed." [1] The position of Mr. Wells is the exact opposite of that of Professor Wagner, who includes in the very definition of a tax the "socio-political" element or the duty of regulating and correcting the distribution and use of private property.[2]

[1] Cooley, *Taxation*, 2d edition, p. 587.
[2] Wagner, *Finanzwissenschaft*, ii. (2d edition, 1890), p. 210.

The one writer would refuse the name "tax" to an imposition looking to anything else than mere revenue: the other ought logically to withhold the name from an imposition *not* looking to anything else than mere revenue. These positions are mutually exclusive and equally extreme.

On the other hand, the distinction of Judge Cooley is almost quite as untenable. Cases where the primary purpose is regulation, he thinks, are referable to the police power; cases where the primary purpose is revenue are referable to the taxing power. Mr. Cooley himself confesses that import duties with incidental protection are taxes. But suppose, as has often occurred, that they are protective duties with incidental revenue. Are they any the less taxes on that account? How about the tax on bachelors, which was imposed for the express purpose of diminishing celibacy? How about the ten per cent tax on state bank notes, imposed avowedly to destroy the state bank issues? How about the American tax on oleomargarine, confessedly of a regulative nature? How about taxes on spirituous liquors in the shape of liquor licenses, to regulate and diminish the liquor traffic? How about the many indirect taxes enacted in consequence of sumptuary laws? How about certain inheritance taxes, whose imposition is demanded on the express ground that they will limit fortunes? How about the single tax, whose only *raison d'être* is the attempt to change the existing distribution of wealth? Shall we call the Indian duty on opium a tax, and refuse the name to the American internal revenue charge, because India looks primarily to revenue, and the United States to regulation? Shall we call the French *impôt des patentes* a tax, and deny the name to the analogous license or privilege taxes in some of the Southern commonwealths, because in the latter case the object is sometimes distinctively regulative? In fact, if this is to be our line of cleavage, we must reconstruct the science of finance and remove from the class of taxes whole categories of impositions to which no one has ever thought of denying the character or name of tax.

The confusion in the American law is at once complimentary and uncomplimentary to the judiciary. It is complimentary in the sense that the judges, when brought face to face with the conflict between constitutional limitations and the demands of social evolution (or what is known in legal parlance as public policy), have sought to remain true to their function as the final interpreters of social progress. This they have been able to do,

however, only through legal fictions and divergent decisions. Anyone who has studied the American law of taxation as a whole must have become painfully conscious of the hopeless contradictions among the laws of the several states on many important points. This condition is due in great measure to the fact that the constitution or laws of one state by implication forbid what the constitution or laws of another state expressly permit. In order to take an actual case, which is perhaps in line with public policy, out of the range of the legal inhibition, the courts of the first state are forced to adopt an interpretation wholly unnecessary in the second. Thus the continuity of social development is preserved, even at the sacrifice of legal consistency or uniformity. For instance, in New York street-car licenses are held to fall under the taxing power, while in Pennsylvania they are put under the police power, simply because, under the particular conditions, it seemed to be a matter of equity, in the one case to uphold, and in the other to object to, such a charge.[1] The payment in the two instances was the same, both in amount and in principle; but the attempt to make the same laws conform to a public policy which differs in the different states has brought about a contradiction. So, too, the whole system of high license or liquor taxes is in some states brought under the taxing power; but in others, because of certain constitutional difficulties, it is put under the police power.[2] To this extent the police power has been a legal fiction to enable the courts to uphold what could not well be brought under the taxing power; although in another leading case [3] the liquor tax was upheld under the taxing power because there was a constitutional obstacle to its being put under the licensing or police power. The police power is of great and growing legal importance in the United States, largely because of the peculiar principles of American governmental relations, whereby local bodies are deemed to have only those powers expressly delegated to them, in contradistinction to the European method according to which local bodies possess, in certain respects, all powers not expressly withheld from them.[4] Many of our cities and towns have no taxing power; and even

[1] *Cf.* 2d Avenue Railroad Cases, 32 N. Y. 261, with Railroad Company *vs.* Philadelphia, 58 Pa. 119. What was held "reasonable" in one case was declared "unreasonable" in the other.

[2] Burch *vs.* Savannah, 42 Ga. 596. *Cf.* 50 Texas, 86.

[3] Youngblood *vs.* Sexton, 32 Mich. 406.

[4] Goodnow, "Powers of Municipalities respecting Public Works," *Publications of the American Economic Association*, ii., pp. 72–79. Professor

when they have the power, it is strictly construed. The courts, therefore, have been compelled to uphold much under the police power that under other and more favorable conditions they would and could have upheld under the taxing power.

On the other hand, there is an element which is not quite so complimentary to the judges. The courts have frequently confused taxes in the narrower sense with the exercise of the taxing power in the wider sense. As we shall see, there are various forms in which the taxing power may manifest itself: taxes in the narrower sense are only one form. Special assessments for instance, have been almost universally upheld as an exercise of the taxing power, while sharply distinguished from taxes in the narrower sense. Yet in a leading case sidewalk assessments, which as a matter of principle do not differ at all from other special assessments upheld under the taxing power, have been declared police regulations.[1] The court has here simply confused taxes with the taxing power. It is, moreover, impossible to see any difference between the various cases of sewer and levee assessments quoted by Mr. Cooley as an exercise of the police power and the cases of sewer and levee assessments quoted by him in another chapter as falling under the taxing power.[2] The whole distinction, in fact, rests upon a confusion. So, again, while both taxes and fees are an exercise of the taxing power, because it has frequently been deemed necessary to uphold license fees by distinguishing them from taxes, many of the courts have declared license fees to be an exercise not of the taxing power but of the police power, thus confusing taxes with the taxing power. There is, as we shall see, a decided difference between a license fee and a tax; but it is not the one stated by the courts. It is this groping after the real distinction between fees and taxes, to be explained in a moment, which has led judges, not trained in economics, to draw the line between payments under the police power and those under the taxing power. The distinction between fees and taxes is not synonymous with the distinction between the police power and the taxing power; for there are many classes of fees, like court fees, fees for legal documents and school fees, which cannot possibly be put under the police power.

Goodnow terms these respectively the systems of legislative and of administrative control.

[1] Godard, Petitioner, 16 Pick. 504, 509, quoted by Cooley, *Taxation*, p. 589.

[2] Cooley, *Taxation*, pp. 588–591, compared with pp. 616–620.

While, then, it may be expedient from the legal point of view to distinguish between the police power and the taxing power, ruling that the one is for regulation and the other for revenue, and while the constitutional importance of the police power, especially in the United States, is in many respects considerable, the distinction from the economic and fiscal standpoint is, nevertheless, wholly unnecessary. A tax is no less a tax because its purpose is regulation or destruction; and a fee or payment for regulation brings in just as much revenue as a precisely identical fee imposed primarily for revenue. From the standpoint of finance the test is not whether the payment is for regulation, but, as we shall see later, whether it is primarily for special benefit or primarily for common benefit; that is, it is a distinction not between police power and taxing power, but between fees and taxes. In other words, payments that are legally put under the police power ought scientifically to be classed under the taxing power.

III. *Fees*

We come finally to what is from the fiscal standpoint the chief sovereign power of the state—the power of taxation. Expropriation is not fiscally important, the significance of fines and penalties does not lie in the financial domain, and the police power, as we have just seen, is of no consequence from the standpoint of revenue; but the taxing power is of an entirely different nature.

The taxing power may manifest itself in three different forms, known respectively as special assessments, fees and taxes. These three forms are all species of taxation in the wider sense, so far as they differ on the one hand from contractual revenue or *quasi*-private income, and on the other hand from the remaining divisions of compulsory revenue, like expropriation and fines. What is common to all three is that they are compulsory contributions levied for the support of government or to defray the expenses incurred for public purposes. That is the essence of the taxing power. But, although they are all forms of taxation in this wider sense, the differences between fees and special assessments on the one hand, and taxes in the narrower sense on the other, are so marked that they must be put into separate categories. Let us study their characteristics, taking up first those payments, like fees, tolls, costs and charges, which may

be summed up under the general head of fees (the German *Gebühren*, the French *taxes*, the Italian *tasse*).

The distinction between fees and taxes, although sometimes ascribed to Rau, is really much older. Adam Smith already speaks of certain expenses "which are laid out for the benefit of the whole society." "It is reasonable, therefore," he adds, "that they should be defrayed by the general contribution of the whole society, all the different members contributing as nearly as possible in proportion to their respective abilities." These, as he afterward explains, are taxes. On the other hand, he speaks of certain outlays, as for justice, for "persons who give occasion to this expense," and "who are most immediately benefited by this expense." The expenditures, therefore, he thinks, "may very properly be defrayed by the particular contributions of these persons," that is, by fees of court. And he extends this principle to tolls of roads and various other expenses.[1] The "particular contributions" of Adam Smith, in distinction from general contributions, are nothing but fees in distinction from taxes. The same distinction is found several decades before Adam Smith in the work of Justi. He, however, like the other Germans of his time, looked upon the *Regalia*, or lucrative prerogatives, as a separate class; and hence classified public revenues into (1) domains, (2) regalia, (3) taxes, and (4) casual revenues, including prices and payments for special privileges.[2] Later on, Rau gave these latter payments the name of *Gebühren* or fees; but the essence of the distinction is to be found in Justi, and still more clearly in Adam Smith.

A fee, then, is a manifestation of the taxing power. It is a compulsory contribution for a service in which the element of public purpose must be present; but it differs from a tax in several important points.

First, a tax is levied as a part of a common burden; a fee is assessed as a payment for a special privilege. The basis of taxation is the ability or the faculty of the taxpayer; the basis of a fee is the special benefit accruing to the individual. In the case of a tax, this ability, it is true, may be influenced to a certain extent by the opportunities or privileges or benefits received. But the difference is the test. In the case of a fee, the benefit is measurable; in the case of a tax, the benefit is not susceptible

[1] *Wealth of Nations*, book v., chap. i., part iv. (vol. ii., p. 402, of Thorold Rogers' edition). Compare book v., chap. i., part ii. and iii., *passim*.

[2] Justi, *Staatswirthschaft*, 2d edition, 1758, ii., pp. 95, 400–429.

of direct measurement. In the case of a fee, the particular advantage is the very reason of the payment; in the case of a tax, the particular advantage, if it exists at all, is simply an incidental result of the state action.

The question of special benefit was originally of minor importance; the mediæval monarch exacted in the shape of fees and charges about what he chose, disguising exactions under the mask of payments for special privileges. Even there, however, it may be said, not that the idea of benefit was absent, but that the monarch made himself the judge of the amount of benefit. That his despotic estimate often resulted in hardship does not alter the theory. Gradually, however, the idea of actual benefit came to the foreground, until it has finally become the controlling factor.

A second distinction between fees and taxes is that a fee does not normally exceed the cost of the particular service to the individual. This, however, although commonly made much of, is of subordinate importance. In the first place, it can obviously apply only to those fees paid in return for some positive work done by government. The government, indeed, must always give something in return for a fee; but in many cases it may give only a permission to do something—a permission which costs almost nothing, and for which a considerable fee may be exacted. The controlling consideration here is not cost, but measurable special benefit. Historically, we know that these special charges were made entirely irrespective of cost.[1] But even in the case of a positive action by the government, cost is simply another method of measuring special benefit.[2] This has been overlooked, but is none the less true. In all competitive private enterprises the benefit to the individual is the cost. That is, the amount which the individual is willing to pay—and he is the best judge of the benefit to be derived—is the price; and the price is fixed ultimately at the cost of production. The whole modern theory of marginal utility as the regulator of price is simply a way of stating the degree of special benefit to the individual; and the true theory of price confesses that marginal utility in competitive

[1] Professor Brentano calls attention to this historical fact. *Cf.* Faber, *Die Entstehung des Agrarschutzes in England*, p. 58. Both fail to notice the points made in the text.

[2] The cost here referred to is at once the cost to the individual and the cost to the government. They are synonymous, because under the supposition the government gives its services for cost.

enterprises resolves itself ultimately into cost of production. The benefit to the individual, therefore, is the cost. As soon as we have a private monopoly, however, the benefit to the individual diminishes in proportion to the sacrifice he is compelled to make in paying more than the cost of production; and the excess of price over the normal benefit (as measured by cost) represents to this extent a tax on the individual.

The same is true of governmental action. It may, and often does, happen that a government is not actuated by motives of profit, but, like a private competitor, sells its services for cost. Special benefit to the individual and cost to the government are then synonymous. But if the government seeks to make a monopoly profit and charges more than cost, then as before the special benefit to the individual may be said relatively to diminish as the charges increase, until finally the exaction becomes so great that the special benefit is merged in the special burden and the charge becomes not a counterpayment, but a special tax. On the other hand, the government may decide to charge less than cost, or even to offer its services gratuitously, in which cases the special benefit to the individual may gradually be swallowed up in the common benefit. Here the very reason of the gratuitous service is that no special benefit exists, or that it results only incidentally from general state action. Thus we see that special benefit to the individual is correlative with cost to the government. If the charge is less than cost, the special benefit is *pro tanto* converted into a common benefit, until finally there is no charge, because no special benefit. If the charge is more than cost, the special benefit is *pro tanto* converted into a special burden, until finally the charge is all tax, because it is all burden, and no special benefit.

This point of view helps us out of a difficulty as to the line of cleavage between fees and taxes. Thus, if a charge is made for the cost of judicial process, the payment is a fee, because of the special benefit to the litigant. If no charge is made, the cost of the process must be defrayed by general taxation; and the litigant pays his share in general taxes. If the charge is so arranged as to bring in a considerable net revenue to the government, the payment by the litigant is a tax—not a general tax on all taxpayers, but a special tax on litigants, like the tax on lawsuits in some of our Southern commonwealths. The character of fee disappears only secondarily because the principle of cost is deviated from, but primarily because the special benefit to the liti-

gant is converted in the first case into a common benefit shared with the rest of the community, and in the second case into a special burden. The failure to grasp the basis of this distinction, which is equally true of other fees, has confused many writers.

A third distinction between fees and taxes may be found in the conditions attached to the service which the government performs. It may be said that in the case of a fee the government does some particular thing in return, while in the case of a tax it gives no special service. The particular thing done by the government in return for a fee may be either the display of some positive energy, as in furnishing a water supply, or it may be a simple permission to do something. The government may create direct utilities, or it may permit the individual to create utilities; but in each case it demands a return for the privilege. In the case of a tax, on the other hand, the government simply refrains from doing; or, if it does anything at all, does it only as a general governmental action. This distinction applies to so-called special taxes, as well as to general taxes; for even in the case of a special tax, the government does not pledge itself to do any special thing for the individual as an individual. It agrees to do some special thing for the community or for the particular class involved, but it is wholly immaterial to the government whether the individual avails himself of the incidental advantage accruing to the class as a whole. Even in the case of special taxes we are not confronted with the principle of give and take, or *quid pro quo*, as regards individuals.

A further distinction that has been very fruitful of confusion is that between the business licenses or fees, and business taxes. The legal terms applied to such payments must not lead us astray. For instance, a given charge levied on certain retail businesses is called in various American states a fee, a license, a license fee, a license tax, a special tax, a specific tax, a privilege tax and an occupation tax.[1] A certain payment exacted from insurance companies is called indifferently an insurance fee, an insurance license, an insurance license fee, an insurance tax and an insurance license tax. A certain payment imposed on some corporations is called variously a charter fee, a bonus on charters, a license tax, a tax on certificates, an organization tax, a corporation tax and even a corporate franchise tax.[2]

[1] Compare my monograph on *Finance Statistics of the American Commonwealths*, 1889, pp. 88–96.

[2] Compare *supra*, p. 216.

The real distinction between a license charge and a business tax is that the non-payment of a license charge normally renders the exercise of the business illegal, while the non-payment of a business tax does not render it illegal. More broadly, it may be stated that a license charge is a condition precedent, while a business tax is a condition (if a condition at all) subsequent.

A license charge, however, may be either a license fee or a license tax;[1] and in order to ascertain which it is, we must fall back on the preceding distinctions. When the license is imposed to cover the cost of regulation or to meet the outlay incurred for some improvement of special advantage to the business, it may truly be said that the licensee gets a special benefit from the privilege, a special benefit measured by the cost. The charge would then, as in the common case of cab licenses, be a fee. When, however, the charge for the license to carry on a business, which before the imposition of the restrictive law was open to anyone, is purposely so high as to bring in a distinct net revenue to the government above the cost of regulation, we can no longer properly speak of special benefits to the licensee, since the special benefit is converted into a special burden; the charge is then no longer a license fee, but a license tax. This is the case with some of the so-called license or privilege taxes in the Southern commonwealths.[2] Finally, if the payment is not conditional upon taking out a license, but is assessed on certain elements of the business, such as purchases, sales, capital, *etc.*, as in the French *patentes*, the German *Gewerbesteuer*, and some of the American payments, then we have not license taxes, but business taxes, because the condition is not precedent, but subsequent. The distinction between license tax and business tax is one of condition of payment: the distinction between license fee and license tax is one of benefit and cost.

There is, therefore, some truth at the basis of the distinction

[1] This distinction is overlooked by the American legal writers. Thus Black on *Intoxicating Liquors*, § 108, makes a labored argument to distinguish taxation from license, while in reality he is distinguishing license fees on the one hand from license taxes and business taxes on the other.

[2] This is really the basis of the decision of the United States Supreme Court in the case of Harmon *vs.* City of Chicago, Supreme Court Reporter, xiii., no. 10, p. 306 (Feb. 13, 1893). A license charge for using the Illinois River is declared to be a tax, and in conflict with the interstate commerce provision of the constitution, because it is not a compensation for any specific improvement. In the latter case it would be a license fee or toll, and perfectly valid, as decided in Huse *vs.* Glover, 119 U. S. 543.

drawn by the American judges between the police power and the taxing power; but it is to be understood in a sense quite different from that usually adopted. The distinction should really be drawn between a license fee and a license tax on the one hand, and between a license tax and a business tax on the other. The distinction between police power and taxing power is not valid, because from the broad scientific point of view a fee may be equally an exercise of the taxing power, while a tax is none the less a tax because it is regulative. When the American judges hold that a license fee must "not exceed the necessary or probable expense of issuing the license and of inspecting and regulating the business," [1] they are drawing the line between license fees and license taxes, although legal complications may compel them to assert that it is a distinction between the police power and the taxing power. For instance, the decision that high liquor licenses are not taxes—a decision quite untenable from the standpoint of public finance—is due simply to certain constitutional limitations, and to the policy of upholding such payments. Liquor licenses, if high enough, are no less taxes than the Southern license or privilege taxes; and the attempt to call them license fees, in order to uphold them under the police power, is the result of a praiseworthy but palpable legal fiction. To say, as Cooley does, that a high liquor license is only a license fee covering the cost of regulation, because "it is reasonable to take into account all the incidental consequences that may be likely to subject the public to cost" (such as prevention of resulting crime and disorder), is a considerable stretching of the term. It seems impossible to state how much of pauperism and crime is due to drink and how much to other causes.

The truth which the judges have vaguely seen, and which they have attempted to realize in their decisions, then, is simply this: a fee is a payment for a service or privilege from which a special measurable benefit is derived, and normally does not exceed the cost of the service; a tax is a payment where the special benefit is merged in the common benefit, or is converted into a burden. A fee remains a fee, whether levied under the taxing power or the police power; and a tax is no less a tax when classified under the police power than when put under the taxing power.

It seems, then, that writers like Professor Bastable, who desire to discard fees as a source of revenue co-ordinate with

[1] Cooley, *Taxation*, p. 598.

taxes, are taking a step backward, and are abandoning a distinction dating back at least to Adam Smith.

It is, however, useless to oppose the creation of a class of revenues co-ordinate with taxes; for, even if we disregard fees, we cannot shut our eyes, as most writers have done, to the existence of another important class of compulsory revenues which are not taxes. These are known as special assessments.

IV. *Special Assessments*

It has already been pointed out that classification of public revenues has depended upon historical conditions. Special assessments are a comparatively modern and a specifically American development, although the germ of the system may be found in the Roman edict: *Construat vias publicas unusquisque secundum propriam domum.*[1] In France and England they have been so rarely used as to escape detection, although of late years the policy of introducing the principle more widely has begun to be discussed in England.[2] In Belgium and Germany they have been introduced in the past few decades, and are occasionally mentioned in the latter country under the head of *Beiträge.*[3] Even so recent writers as Leroy-Beaulieu and Bastable ignore them completely, in the earlier editions of their books on public finance. Nowhere do we find any adequate discussion of special assessments in theory or in practice, or any successful attempt to correlate them with other forms of compulsory contributions.

[1] Quoted in entirety in another connection by Sax, *Die Verkehrsmittel in Volks- und Staatswirthschaft*, i., p. 186.

[2] In France they may be traced back to 1672 and to a more general law of 1807, known as the law on "l'indemnité pour payement de plus-value." But only about twenty to twenty-five cases of application are known. Compare Aucoc, *Droit Administratif*, ii., p. 732 *et seq.* For the earlier cases, see Clément, *La Police sous Louis* XIV., p. 144.—For England see *infra*, chap. xv.

[3] In Prussia they are legally known as *Interessentenzuschüsse.* Compare Leidig, *Preussisches Stadtrecht*, p. 375, and Loening, *Verwaltungsrecht*, p. 580. Other forms of special assessments are known as *Deichbeiträge*, and in Baden as *Soziallasten.* The whole system seems to have received a greater development in Belgium than anywhere else in Europe, and yet it has not been noticed at all. The Belgian, Denis, does not mention it in his recent work, *L'Impôt.* The details of the system may, however, be found in Leeman's *Des Impositions Communales en Belgique*, 2d edition, chaps. v.–x. He calls them *taxes*, but confuses them continually with taxes proper, including special taxes.

No American who treats of public finance as a whole can fail to be struck with the importance of special assessments in actual practice. To take only two examples: in New York city, in 1891, special assessments yielded over $2,400,000; while in Chicago, in 1890, they yielded $8,790,443—a sum actually larger than that raised by taxes. The courts have been filled with litigation respecting special assessments, and certain valuable principles have been slowly evolved. Yet no one has attempted to construct a theory of special assessments, or to assign them to their proper place in the list of public revenues. Thus the theory of special assessments has not been worked out in Europe, because the facts were not deemed sufficiently important; and it has not been worked out in America, because there have been almost no American theorists in public finance.[1]

A special assessment may be defined as a compulsory contribution, levied in proportion to the special benefits derived, to defray the costs of a specific improvement to property undertaken in the public interest. When a new street is opened, for instance, it is deemed equitable that the expense should not be entirely borne by the whole community, but that it should be defrayed in part or in whole by the owners of abutting real estate, whose property receives an undeniable benefit in the immediate enhancement of value. The advantages of the particular government services accrue in great part to the property owners; and it is therefore right that they should bear the burden in proportion to the advantages received. Without going into the history of the system, we may say that, beginning in New York in the seventeenth century, it has been well-nigh universally adopted in the United States. Its operation extends to improvements like the following: opening, laying out, grading, paving and repaving, planking and curbing the streets; sprinkling them with water, illuminating them with gas and electric light, and even ornamenting them with shade-trees; constructing drains, sewers, levees and embankments; laying wire conduits and water pipes; bettering waterways and dredging rivers; laying out and developing public parks, squares and drives. In

[1] Shortly after the above words were originally published, Dr. Victor Rosewater, later editor of the *Omaha Bee*, completed his monograph on *Special Assessments: a Study in Municipal Finance*, which appeared as vol. ii., no. 3 of the Columbia University *Studies in History, Economics and Public Law*, 2d ed., 1898. This monograph contains a comprehensive treatment of the whole subject, historical, legal, statistical and theoretical, and is now the chief authority on the topic.

all these cases the entire expense, or a certain portion of it, is met not by general taxes, but by special assessments. We are here to consider the theory of special assessments.

In the first place, special assessments represent an exercise of the taxing power. In the early days various attempts were made to justify them under the power of eminent domain and under the police power; but in 1851 a leading New York case[1] swept away all these refinements, and decided that special assessments were a constitutional exercise of the taxing power. The reasoning of Judge Ruggles in that case is so convincing as to need no comment or defence; and the whole development in the United States has since proceeded on the line he laid down.

In a special assessment the element of public purpose must always be present; for if levied solely for private purpose it would be an act of confiscation, not an exercise of the taxing power. Again, a special assessment must be capable of apportionment: there must be an assessment district, and the assessment must not be arbitrary. The countless cases which enforce these points show, in short, that special assessments, like fees, are an exercise of the taxing power.

Special assessments, like fees, are not, however, taxes in the ordinary or narrower sense. Taxes, as we know, are compulsory contributions levied to defray the expenses incurred in the common interest, without any reference to particular advantages accruing to the taxpayer; but in special assessments, as in fees, the services for which the expenses are incurred redound to the particular benefit of the individual. The primary test of a tax is that it imposes a common burden: the primary test of a special assessment is that it implies a special benefit. From this one great distinction flow all the others, which may be summed up as follows:—

First. In a special assessment the special benefit to the individual is measurable. In a tax the special benefit does not exist, or, if it exists at all, results incidentally from the individual's share in the common benefit; it is not separately measurable. No one, perhaps, will be apt to confound a special assessment with a general tax; but there is also a clear line of distinction between a special assessment and a special tax. An adequate

[1] People *vs.* Brooklyn, 4 N. Y. 419. Some of Judge Ruggles' *obiter dicta* on the principles of taxation are open to serious question. But as they have really nothing to do with the point decided in the case, we pass them by.

discussion of the relation between a general tax and a special tax belongs to the question of the sub-classification of taxes in particular, and would lead us too far astray here. But we can say at all events this: a general tax, like the ordinary state or local tax in America, is not levied for any definite, particular expenditure, but is assessed for general governmental purposes: a special tax, like the English local rates or the local taxes in some American states, like New Jersey, is assessed for the accomplishment of some special task to which the government is pledged, and is levied on a definite section of the population.[1] The police rate, the sewer rate, the poor rate, the lighting rate, are each levied for the special purpose and on the definite class of taxables subject to the rate. But this special tax is none the less a veritable tax; it is levied for a public purpose, it is assessed on what is deemed to be the faculty or "means" of the taxpayer; and there are no particular benefits accruing to him as an individual. Even if he does perchance derive a benefit, it is not a special, measurable, individual benefit apart from the common benefit that the other members of the class derive; it is simply an incidental result of his share in the common benefit. In the special assessment, on the other hand, the special individual benefit is distinctly measurable and forms the basis of the assessment. The English local rates, for instance, might seem to be in no wise distinguishable from the American assessments. It is a clear principle of the English system of local rates, however, that "the exact measure of the benefit is not the measure of the liability to be taxed," while the reverse is true in the American system of special assessments. In other words, the test of the special assessment is measurable special benefit: the test of the special tax is special taxable capacity or faculty, just as the test of the general tax is general taxable capacity or faculty. The distinction is quite clear; yet the few writers who have spoken of special taxes at all have almost universally confused them with special assessments.

Secondly. Taxes may be proportional to property, or to income, or to expense, or to any other test of faculty, or they may be progressive rather than proportional; special assessments can never be progressive, but must always be proportional to benefits. This is the recognized principle in American juris-

[1] These taxes must of course not be confounded with the so-called "special taxes" in some of the Southern commonwealths, which are known as license or privilege or business taxes in the other commonwealths.

prudence; and the only difficulty now is to decide what is to be regarded as the most equitable standard for the measurement of benefit. Acreage, frontage, value, superficial area of the property—all these have been upheld as proper guides to apportionment, and as constitutional tests of presumptive special benefit. Not only are special assessments void when there is no special benefit; they are also voidable when the charge exceeds the special benefit;[1] for to charge more than the exact benefit would be equivalent to taking private property without due compensation. In the special assessment there must be compensation; in the tax there is no question of compensation. The only matter in dispute in the American courts is whether the special benefit need be actual or may be presumptive; the general tendency of the decisions is to make the legislative and administrative discretion rather wide.[2]

Thirdly. Special assessments are confined to specific local improvements, while the sphere within which taxes operate is in this respect unlimited.

Fourthly. For a special assessment the government performs a definite, particular act in return; it is an instance of service and counter-service, of give and take. For a tax the government does not pledge itself to do a particular thing for the particular individual in return. The reasoning here is precisely the same as that adduced above in discussing the distinction between taxes and fees. A special assessment is here on exactly the same footing as a fee.

Fifthly. Taxation is resorted to in order to defray the running expenses of government, and to effect in time the amortization of the debt; while the object of special assessments is in the main to provide for the capital account—to increase, as it were, the permanent plant of the community.[3]

The distinction between special assessments and taxes has been widely recognized in American jurisprudence; and the constitutional limitations applied to taxation have generally been declared inapplicable to special assessments. As Cooley puts it, "The overwhelming weight of authority is in favor of the position that all such provisions for equality and uniformity

[1] *Cf.* the celebrated Agens cases in New Jersey. State *vs.* Newark, 37 N. J. L. 415; Bogert *vs.* Elizabeth, 27 N. J. Eq. 508.

[2] *Cf.* Matter of Church, 92 N. Y. 6; Allen *vs.* Drew, 44 Vt. 174, and other cases cited in Rosewater, *Special Assessments.*

[3] Only very rarely is there a departure from this rule, as, *e. g.* where the cost of sprinkling the streets is occasionally defrayed by special assessments

in taxation by value have no application to special assessments." Exemptions from taxation, moreover, do not imply exemptions from special assessments. Special assessments are none the less a distinct class because in some laws they are called taxes. In some cases, in their anxiety to uphold the distinction, the same courts interpret the word "assessment" in the phrase "uniform rate of assessment and taxation" sometimes in one way, sometimes in the other. That is, when special assessments must be put under the taxing power in order to be upheld, "assessment" is held to be used in the general sense, and to mean taxation; when in other cases special assessments can be upheld only by being distinguished from taxes, "assessment" is held to be used in the technical sense, and to mean something different from taxation. All the ingenuity of the American judges has been needed to attain the result now achieved—the marked distinction between special assessments and taxes;[1] but their efforts have been sensible, and the result is in accord with the teaching of the science of finance.

Special assessments hence are not taxes. They differ from taxes in the same way that fees differ from taxes, since both fees and special assessments rest on the doctrine of equivalents. Fees, special assessments and taxes have points in common in that they are all manifestations of the taxing power. Fees and special

[1] One recent case is especially noteworthy as illustrative of ingenious distinction. The general trend of authority, as we have shown, is to give a wide discretion, and to uphold assessments per front foot as a good presumptive test of special benefit. Yet in the celebrated Illinois case of Chicago *vs.* Larned, 34 Ill. 203 (1864), the court held that the provisions of the constitution as to uniformity and equality of taxation were unusually stringent, and were applicable also to special assessments. The court was really mistaken here, as the Illinois constitution did not differ from many others where the contrary interpretation was adopted. Still, as a consequence of their view, assessments could be made on each lot only up to benefit actually proved, while the remainder of the cost would have to be defrayed by general taxes. Assessment by front foot was held to be invalid. Yet later the courts evaded this case by a very fine distinction. The constitution of 1870 gave local authorities the right to levy "special taxes for local improvement;" and in White *vs.* People, 94 Ill. 613, the court held that a special tax was not a special assessment, and that a special tax might exceed the actual benefits to the particular lot. An assessment by front foot is hence valid, and the system in Illinois to-day is the same as in other states. Of course the "special tax" of the Illinois constitution is simply the "special assessment" of other states, and is even known by the latter name in Illinois itself. There is, as we have seen, a distinction between a special tax and a special assessment; but it is not the distinction drawn by the Illinois court.

assessments have additional points in common, which they both possess in distinction from taxes. But, finally, fees and special assessments differ in some respects from each other. We have distinguished special assessments from taxes; it remains to distinguish them from fees.

It may, indeed, be claimed that there is no distinction, and that special assessments simply constitute a sub-class of fees. It is true, as has just been pointed out, that what characterizes taxes proper as against the other manifestations of the taxing power is general benefit as against measurable special benefit. If we name the first kind taxes, we might indeed give to the second kind some generic name. Special assessments would then be simply a distinct sub-class. But they are so extremely important and so far overshadow all the other cases of special benefit taken together, that it seems advisable to put them into a separate category. Especially in the United States, where the judges are just beginning to wrestle with the actual problems, it would tend to confuse rather than to clarify, if we put special assessments and cab licenses, for instance, into the same category. Let us then attempt to point out in what respects special assessments differ from fees.

In the first place, special assessments are levied only for specific local improvements: fees may be levied for any services. The field of operation of special assessments is restricted; that of fees is unrestricted.

Secondly, special assessments are paid once and for all; fees are paid periodically, according to each successive service. The only qualifications to this statement are that special assessments may, in a few cases, be spread over a longer period, and may then be payable by regular instalments;[1] while, on the other hand, a fee is of course paid only once if the service is demanded only once, as in the case of a marriage fee. That, however, does not invalidate the distinction. In the special assessment the payment is capitalized in a lump sum, payable generally at once, but occasionally by instalments; in the fee, on the other hand, the payment is, so to speak, fragmentary and irregular. In a given case there may be a choice of methods. For instance,

[1] *Cf.* the New York Law of 1912, chap. 372, which provides that if the assessment exceeds five per cent of the tax valuation for the preceding year, the collector shall divide the assessment into ten instalments, as nearly equal as may be. Each instalment after the first is to bear five per cent interest until due, and seven per cent thereafter until paid.

in constructing a bridge, the cost may be defrayed either by levying a special assessment on the owners of the abutting property or by charging tolls on those using the bridge, who are presumably in great part also the owners of abutting property or their friends and dependents. If the benefits redound in greater part to these property owners, the cost should be paid by a special assessment; if the benefits redound in greater part to individuals who are not property owners, the cost should be paid by a fee (toll); if the benefits are so wide-spread that the whole community is almost equally interested, the cost should be paid by neither a special assessment nor a fee, but by a general tax.

Thirdly, a fee is levied on an individual as such: a special assessment is levied on an individual as a member of a class. That is, in the case of special assessments there must always be an assessment area over which the whole assessment is levied, to be then further distributed according to a definite rule of apportionment. It is, for instance, a settled rule of the American law, that in assessing benefits the assessors cannot restrict themselves to the cost of the improvement in front of a particular lot.[1] In the case of a fee, on the other hand, the government looks not to a class or to an area, but to the separate individual.

Fourthly, a special assessment must always involve a benefit to real estate: a fee is paid for a service which may benefit other elements than real estate, such as personal property, or other attributes of the individual without any reference to property.

There is one further distinction, which, however, is more imaginary than real. It might be maintained that special assessments are like direct taxes, and fees like indirect taxes, in the sense of taxes on consumption or on acts and communication, because the former are compulsory and the latter voluntary. But this distinction is badly expressed, and really untenable; for, notwithstanding the contrary statement, which has frequently been made, indirect taxes are not a whit more voluntary than direct taxes. It is true that if a man chooses to go without tobacco he may escape the tobacco tax; but it is equally true that if a man chooses to go without certain kinds of property or income, he may escape to that extent the property tax or the income tax. Indirect as well as direct taxes are compulsory, not voluntary, contributions. In the same way, there is no truth in the statement that a fee is voluntary and a special assessment

[1] *Ex parte* Mayor of Albany, 23 Wend. 277.

compulsory. It is true that we do not need to pay a peddler's license fee if we do not care to peddle; but, on the other hand, we do not need to pay a special assessment if we do not care to own the land. Further, when the payment of a fee is connected with necessary every-day transactions, as are mortgage registrations fees or marriage fees, there can be no question of the compulsory nature of the transaction. Birth and death cannot well be termed voluntary actions; yet a registration fee for a birth or death certificate does not differ in character from any other fee. Fees and special assessments. indirect and direct taxes, are all compulsory contributions.[1]

It is clear, then, that there is a line of distinction between fees and special assessments, although not so sharp as between fees and special assessments on the one hand and taxes on the other. There is no danger of confusing them in practice; yet very little has been done to differentiate them in theory. Even Wagner, though compelled in the last edition of his work to recognize the existence of "*Beiträge*," mentions them in a few lines as merely an unimportant addendum to fees. Of course, it would be easy to follow Professor Bastable's example, and deny the existence of fees as a separate class, in order to avoid the "creation of a distinct group of state receipts co-ordinate with that derived from taxation." [2] But even he, when confronted with the existence of special assessments, will have to revise his classification, and create at least one "distinct group co-ordinate with" taxes. And if this one group is separated from taxes, it will be difficult to refuse to cut off another group, for the arguments that apply in the one case apply equally well in the other. [3]

V. *Prices*

We now come to a final problem which has given rise to considerable difficulty. Where shall we class the payments made for services rendered by certain governmental enterprises, like canals, postoffice, telegraph and railroads? Are they taxes, are they fees, are they compulsory payments at

[1] Neumann, who is the only writer to attempt a distinction between fees and special assessments, makes it turn on a very dubious distinction between direct and indirect taxes. *Die Steuer und das öffentliche Interesse*, pp. 327, 334.

[2] *Public Finance*, p. 221.

[3] Professor Plehn, *Introduction to Public Finance*, New York, 3d ed., 1909, p. 354, prefers to consider special assessments as a class of fees. On the other

all, or are they not rather to be called prices, and classed with the contractual income of the state?

Some writers say that if the government goes into a public business, like the postoffice, the charges are compulsory; but that if it goes into a private business, like a shoe factory or a coal yard, the revenue belongs to the industrial domain. This seems to be a decided mistake; for there is no such sharp line of demarcation between a naturally public and a naturally private business. Everything depends on the view taken for the time being as to the policy of governmental interference. The postoffice is everywhere in the hands of the government, simply because the enterprise arose at a time when there was no dispute over the policy. The telegraph, the telephone, and still more the railroad are controlled by the government in some countries, and by individuals in other countries, because these industries developed after the discussion as to the limits of governmental interference arose. Where shall we put the gas industry, which in some municipalities is a public, and in others a private, business? Where shall we put the water-supply and the street-railway business? Some countries have monopolies of the manufacture of salt and of tobacco, which are then regarded as modes of taxing the people who use salt and tobacco. Would there be any difference in principle if the government went into the coal business or into the shoe business, in order to tax the people using coal or shoes? It might indeed be very bad policy for the government to extend its functions; but there is no natural and immutable line of cleavage between a public and a private business, between a monopoly of tobacco and a monopoly of bread or of iron. The limit is always fixed in accordance with temporary public feeling as to the proper social policy; but the question as to how far vital public interests are at stake has been answered, and will always be answered, differently in different countries and in different ages.

The distinction, therefore, is not, as most writers have assumed, dependent on the nature of the enterprise.[1] As a matter

hand, my contention has now been accepted by Leroy-Beaulieu, *Traité de la science des finances*, 6th ed., 1899, vol. i., chap. vii.; Graziani, *Istituzioni di Scienza delle Finanze*, 2d ed., 1911, p. 193; Nicholson, *Principles of Political Economy*, iii., 282; H. C. Adams, *The Science of Finance*, 1899, p. 227, and T. K. Urdahl, *The Fee System in the U. S.*, 1898, p. 60.

[1] For instance, Wagner classes telegraph and postal charges among fees, railroad charges among industrial revenues. Schall limits fees to services for "essential state purposes" (*wesentliche Staatszwecken*). Compare Schön-

of fact, the payment for the same service may be a price in one state, a fee in a second, or a tax in a third. The explanation of the difficulty is to be sought in an elaboration of the very principle which has just been employed to show the difference between special assessments, fees and taxes. In other words, the controlling consideration in the classification of public revenues is not so much the conditions attending the action of government or the kinds of business conducted by the government as the economic relations existing between the individual and the government.

Let us attempt to make this clear by taking up in turn the various classes of revenue.

The simplest case arises when government decides to go into a purely private business. The government sees private individuals making money out of certain occupations, and considers why it also should not do likewise. It therefore enters upon the business, and conducts it in precisely the same way as would an individual. Such instances were very common in former times, when governments carried on all kinds of private occupations, such as manufacturing pottery, loaning money, or conducting commercial enterprises; but in modern times this has become less usual. Many states, nevertheless, still own real estate, either renting or utilizing it and selling the produce in the open market; some states still carry on a banking business; and others deal in commodities, like Holland in tobacco, Chili in guano, and India in opium. In all such cases the chief consideration with the government is fiscal; and the charges are precisely the same as would be made by private individuals. In fixing the price, the government is actuated by the same motives that obtain in private business, whether the business be competitive or monopolistic. It is immaterial to the purchaser whether he buys from the state or from a private person; for he has to pay the same in each case. The commodity or service supplies his own private wants, and there is nothing public about the transaction except the mere accident that the seller is a public agent rather than a private person. The charge made by the government is therefore a *quasi*-private price; it is a purely contractual payment, resting

berg's *Handbuch der politischen Oekonomie*, iii. (3d edition), p. 98. Roscher (*Finanzwissenschaft*, p. 22) and Vocke (*Die Abgaben, Auflagen und die Steuer*, pp. 223-565) also except payments for post, telegraph and railroads from the category of fees.

on an agreement between the government and the purchaser. The special benefit which the individual receives is to him the controlling consideration; and the matter of general interest or of public purpose is only an incidental matter.

We now come to the next case, where the government decides, for special reasons not purely fiscal, to enter upon certain enterprises which have more or less of an industrial nature. It is found by experience that the retention of these enterprises in unregulated private hands is not thoroughly satisfactory. The government, therefore, either leaves these occupations to private initiative, but subject to careful regulation, or takes such business into its own hands. The reason for interference is not public gain, but public policy; it is now a matter of common interest, and no longer purely and solely of private interest.

The familiar examples of such enterprises are the postoffice, the telegraph, the telephone, the railway, the water, gas and electric-light supply. These are often called economic monopolies, because in them through the working of economic forces competition tends to become entirely inoperative. In most cases, too, they can be carried on only in virtue of some privilege or franchise conferred by the government. The public interest is therefore admittedly strong; and whether it takes the shape of governmental regulation or of governmental ownership is, for our special purpose, immaterial.

Let us assume the latter case. The problem then arises: What is the nature of the charge made by the government for the service or for the commodity which results from the operation of these enterprises?

The chief point is still the private interest of the individual. He buys his gas or his telegraph service to satisfy his private wants, very much as he would buy it from any individual or corporation. But a new element has entered,—the element of public interest, the satisfaction of the wants which one feels as a member of the community. The very reason why these enterprises have been made government enterprises is that the individuals who compose the community feel that they have a common, public interest in the assumption of the business by the government. They believe in municipal water-supply, for instance, because they are convinced for various reasons that this business ought not to be left in private hands. The government, indeed, may make a charge, which is undoubtedly

a price paid by the individual; but it differs from private prices. In the case of the private business the monopoly seeks only the greatest possible profits; in the case of the public monopoly the government seeks the greatest possible public utility. Even when the government makes a high charge, it does not aim simply at the maximum monopoly profits; for the public element always modifies the charges in some particular. If it did not so modify the charges, or at all events give better facilities for the same charge, there would be no reason for the assumption of the business by the public.

The charge to the individual is thus a price; but, instead of being *quasi*-private, it is now a public price.[1] The relation of the government to the individual is not the same as in the preceding case. The special benefit to the individual, although it is still preponderant, is relatively less; the public purpose has become of more importance.

We come now to the really important point: The feelings of the citizens may undergo a further change, and the government may conclude to manage the enterprise in a different way. The element of private interest or special benefit may diminish, and the feeling of public interest may increase so as to become the controlling consideration. The government, because of these changed conditions, will now decide no longer to run the business on the principle of profits. It will reduce the charges somewhat, so as perhaps only to cover the cost of operation, or not even to cover this cost. While it will still roughly endeavor to charge each individual according to the benefit he derives, it will still further modify these charges in the direction of the public interest, charging less to those who can afford it less. In other words, special benefit to the individual is still measurable and charged for; but since the common interest of the community is now of more importance, the charge for special benefit may be slightly modified by other considerations, as in the case of the postal service, where newspapers are put into a lower class

[1] Professor Plehn prefers the term "rates" to "prices" on the ground that we ordinarily speak of water rates, telegraph rates and the like. *Introduction to Public Finance*, 3d ed., 1909, pp. 88–89. To this, however, there is a double objection—first because the usage is by no means universal—witness water "rents," telephone "tolls," railway "fares," *etc.*, and second, because in countries like England they would at once be confused with the local "rates" or taxes.—The United States Census Bureau's Classification of Public Revenues as published in the volume on *Wealth, Debt and Taxation* (Twelfth Census, 1907) accepts the category of public prices.

than letters. The charge to the individual has now become a fee.

Finally, another change may occur. The citizens may become convinced that the public purpose has become the exclusive consideration, and that the special interest of the individual is swallowed up in the general interest. The government will now entirely abandon the principle of charging according to special benefit for one of two other methods: it will either make no charge at all to the individual for the special service; or, if it still makes a slight charge, it will levy this not according to the principle of special benefits, but primarily according to the principle of faculty or ability to pay. The expenditure must indeed be defrayed, but it will now be met by a general charge on the whole community, or by a charge upon that section of the community which avails itself of the service; but even in the latter case it will not measure the special charge to the individual by the benefits he may personally receive. In other words, the payment is now a tax—in some cases general, in others special.

Let us illustrate this process: While a railway is in private hands, the individual traveller or shipper pays a private price. If the government buys up the railways and manages them in precisely the same way, the payment made by the individual is still a price—a *quasi*-private price, because demanded by the government acting as if it were a private party. But the government, although it still seeks to make a profit, is likely soon to introduce some changes in the public interest. Because of the resulting changed relations between the enterprise and the patron, the payment becomes a public price. After a short time the government may reduce its charges considerably, barely covering the cost, and may modify them still further in regard to individuals or to sections of the country by considerations of public policy. The payment is then practically a fee or toll. Finally, the demand may be made in the public interest, as in Australia to-day, for free railway travel. The payment then made by the community to defray the gratuitous railway service would be a tax. In the case of the common highways and the canals, this same evolution is discernible; and the final stage of free travel has actually been reached.

As another illustration take the water-supply. At first often in the hands of a private company, it may then be managed by the city, but according to the same principles. Every one pays

in proportion to his consumption, but pays more than it costs the city to supply the water; the enterprise is managed on the principle of profits. Then comes a change. The city, still charging according to consumption, limits its charges to cost. Then often comes another change; and the city, while still trying to make both ends meet, often charges each individual a lump sum, but makes the richer consumer pay more than the poorer, even though he consumes no more. Finally, we reach the stage already attained in some European cities, and also demanded for Detroit by Mayor Pingree, where the water is supplied to the citizens without charge, and where the expense of water-supply is put in the same category as the expense of street cleaning. The charge for water-supply has thus run through the various stages—private price, *quasi*-private price, public price, fee, and tax. Some cities, indeed, may have jumped over the intermediate stages, may have started with the final stage, or may never have reached this stage. In fact, although this is unusual, the principle of development may even be reversed, the public interest may lag, and the methods of private management may again be introduced. The principle itself is, however, everywhere discernible, whether it works forward, as it usually does, or backward, as in some exceptional cases.

Again, at the present time the charge for a postal stamp, like a canal or road toll, is almost everywhere a fee; [1] yet the charge might be so high that the special benefit would become a special burden, and the payments would become taxes on communication or on transportation. This was very common in former times. Highways were at first in private hands, and the charge was an extortion levied by the feudal lord. Later the charge became a monopoly tax on transportation; then it became a toll; until to-day the charges have generally disappeared, and the highways are managed on the principle of gratuitous service, and are supported out of the proceeds of a general tax.

What has been said of the railway and of the water-supply, of the postal and of the highway systems, may be repeated of all other governmental enterprises—the canal, the telegraph, the

[1] As early as 1765 Benjamin Franklin perceived, in part at least, the difference between a fee and a tax. In reply to the question of the parliamentary committee, "Is not the post-office a tax as well as a regulation?" he replied, "No: the money paid for the postage of a letter is not of the nature of a tax: it is merely a *quantum meruit* for a service done." Dowell, *History of Taxation and Taxes in England*, ii., p. 46. Franklin, however, failed to see that it might become a tax.

telephone, the gas and the electric light, the horse railway and the trolley line, the docks, the markets and the ferries. Moreover, if the socialistic scheme is ever introduced, the same principle will apply to all the cases of governmental management of what once were private enterprise. Whether the government ought to assume these enterprises is, of course, a question quite apart from this discussion of the economic and fiscal nature of the payments made by the citizens.

The demands made by government for supplying the individual with commodities or services differ in character, then, according to the economic relations between the government and the individual. Just as a fee may become a tax, so it may become a price and *vice versâ*. While a price can never be a tax, the payment for the same service may take the form of a price in one state, a fee in a second, and a tax in a third. The real test is the economic relation between the individual and the government, and the relative strength of the individual private interest as compared with the common or public interest.

While there is thus a clear distinction, chiefly of degree, between a price and a fee, and between a fee and a tax, we find in actual life some payments which combine separate elements, and which it is difficult for anyone but a trained observer to classify. Take, for instance, the combination of price and of tax. If the liquor business is in private hands and the government imposes a tax on each glass sold, the individual pays a certain amount which includes both price and tax. If the price of a glass of liquor was five cents and the government levies a tax of one cent, the individual pays six cents, of which five is the price, and one is the tax. When the government has a monopoly of the liquor manufacture or trade, as in some countries, the relation is exactly the same, and the charge may be even more than six cents. In fact, that is generally the reason why the monopoly is introduced; but it is only the surplus over five cents that is the real tax. The same reasoning applies to other fiscal monopolies, like the tobacco or the sugar or the salt monopoly; the amount which the individual pays over and above what he would have to pay to a private vendor is the indirect tax. This might be true also of the charges for railway or for water-supply; but at present rarely applies, because they are not fiscal monopolies. They may be monopolized by the government; but in almost every case the object is not to raise the price, but to diminish the price—not to make profits, but to secure general

social utility. Yet just as the French and Italian governments impose taxes on the private railway tickets, the amount of which is separately printed, thus enabling the purchaser to distinguish between the price and the tax, the distinction might be made if the railways were owned and managed by the government. The payments would be economically separable.

In the same way, as has already been abundantly illustrated, a given payment may include a fee and a tax. Governments, however, do not usually make this sharp distinction. For instance, some American states speak of insurance fees; other states call the identical payments insurance taxes. In some of the Southern states agricultural fees are sometimes called fertilizer taxes; and on the continent the terms "fees" and "taxes" are often indiscriminately applied. Practically, this may not always be of great importance; but in theory the distinction is clear, and it is beginning to be recognized by the courts.

A more difficult and more confusing case arises when one payment is levied in the form of another, as when a public price is levied in the shape of a tax. Take for instance the water or the gas supply. In Europe, when the towns bought out the private water or gas companies, they at first continued, as some do yet, to charge according to individual consumption. In some cases, however, for purposes of convenience, they assumed that each household would use a certain quantity; and as some of the local taxes were levied on the occupier, they simply added a certain amount to the tax, as in some English towns where a special water rate is levied like the other local rates, or as in Austria where an addition is made to the local tax on house rent. The payment is nevertheless a price, and not a tax; for if more than the assumed normal quantity is used by anyone, especially by a business man or by a factory-owner, the charges are increased according to the consumption. If the charges were reduced, or if all idea of special benefit were abandoned and the charge were assessed on the whole community or on a part of community irrespective of the relative quantities consumed, then the payment might become a fee or even a tax, whether general or special. As a matter of fact, however, in most places to-day the payment is still a price, even though sometimes levied in the shape of a tax. Thus, the English have a separate class of municipal revenues called income from "gas and water undertakings," which shows that the distinction is dimly recognized. In New York the charge for Croton water is technically called the "water

rate," or "water rent," although most people call it the water tax, and confound it with a genuine tax. Here, it is true, this "rate" is paid separately; but in some of the European cities, for purposes of convenience, it is simply added to an existing tax. Nevertheless so long as the economic relation of individual to the government is different, the charges, even though confused under the same appellation, are really distinct.

VI. *Conclusions*

To sum up the preceding discussion, we find that under actual conditions all public revenues are either gratuitous, contractual or compulsory contributions; that the compulsory contributions are levied in virtue of the power of eminent domain, of the penal power (either as a separate power or as the fiscally important part of the police power), or of the taxing power; and, finally, that the taxing power manifests itself in three forms of fees, special assessments and taxes.

In regard to the charges known as prices, there is no doubt that we must put quasi-private prices under the head of contractual payments; but public prices—the charges made for industrial enterprises under certain conditions—occupy a middle position, and might be called semi-compulsory. If the government manages an enterprise just like an individual, the price is virtually a contractual payment; if the government makes the whole community or part of the community pay, it is a compulsory payment; but if the government employs the intermediate principle of charge, the payment is neither wholly contractual nor wholly compulsory, but contains elements of each. The classification would then be as follows:—

Revenues	Gratuitous	. . . .	Gifts.
	Contractual.	Public Property and Industry	Prices.
	Compulsory	Eminent Domain	Expropriation.
		Penal Power	Fines and Penalties.
		Taxing Power	Fees.
			Special Assessments.
			Taxes.

But if the real distinction is, as we have suggested, the economic relation of the individual to the government, the classification of charges would depend upon the importance of the individual interest measured by the special benefit to

the individual, as compared with the common interest or public purpose measured by the ability of the individual to contribute to public charges. In the one case the individual is the chief or only factor; in the other case the individual sinks his own importance in the common welfare of the community, and whatever benefits he derives come to him only incidentally as a result of his membership in the community. At one extreme lie prices, which depend upon the relation of the government to some particular industry or individual; at the other extreme lie taxes, which depend upon the relation of the government to all industries or individuals; midway between these extremes lie fees. From this point of view, if we omit, as of no importance, expropriations and fines, there are only three great classes: *viz.*, prices, fees and taxes. The essential characteristic of a fee is the existence of a measurable special benefit, together with a predominant public purpose: the absence of public purpose makes the payment a price; the absence of special benefit makes it a tax.

As these elements are, however, present in varying degree in different payments, the charges shade off into each other almost imperceptibly, forming intermediate classes which are of great practical importance. Thus the public price has certain elements of the price and certain elements of the fee; but it is of sufficient importance to warrant its separation in a distinct category. Again, as we have seen, a special assessment has many points in common with the fee, but has a decided significance of its own. Our final classification would then be as follows:—

1. Special benefit the exclusive consideration.	Public purpose incidental.	Quasi-private Price.
2. Less special benefit, although still preponderant.	Public purpose of some importance.	Public Price.
3. Special benefit measurable.	Public purpose of still greater importance.	Fee.
4. Special benefits still assumed.	Public purpose the controlling consideration.	Special Assessment.
5. Special benefits only an incidental result.	Public purpose the exclusive consideration, principle of faculty or ability.	Tax.

The above classification would result in the following definitions:—

A quasi-private price is a voluntary payment made by an individual for a service or commodity sold by the government in the same way as a private individual would sell.

A public price is a payment made by an individual for a service or commodity sold by the government primarily for the special benefit of the individual, but secondarily in the interest of the community.

A fee is a payment to defray the cost of each recurring service undertaken by the government primarily in the public interest, but conferring a measurable special advantage on the fee-payer.

A special assessment is a payment made once and for all to defray the cost of a specific improvement to property undertaken in the public interest, and levied by the government in proportion to the particular benefit accruing to the property owner.

A tax is a compulsory contribution from the person to the government to defray the expenses incurred in the common interest of all, without reference to special benefits conferred.

Note to 9th ed. The classification set forth in the above pages has now, it may be said, been accepted by virtually all important writers. The most detailed work in the last two decades has been done by Italian writers. *Cf.* notably as to special assessments P. Jannaccone, *I tributi speciali nella scienza delle finanze*, Torino, 1905; as to fees, A. Vita, *Le tasse nella dottrina scientifica*, Milan, 1911; and as to prices Salvatore Majorana, *La classificazione delle publiche entrate dei prezzi*, Rome, 1920. The latter writer compares at some length my suggestions with these of Einaudi who makes a triple, and somewhat different division into private, quasi-private and public prices.

CHAPTER XV

THE BETTERMENT TAX

IT has often happened that the technical name of a new custom has been borrowed from abroad; but it is rare to find a foreign institution described by an exceedingly uncommon term, which is then naturalized on the assumption that foreign usage is being followed. This, however, is the case with the "Betterment Tax" in England. The institution is indeed found in America, but the name is unusual there. Exactly when and how the term came to be introduced into England is uncertain;[1] but nine out of ten Englishmen, when using the expression, think that they are following the American custom. The term has now become so current in England that it may be considered as firmly established.

I. *The Origin*

The principle of betterment has recently been defined by an official commission as "the principle that persons whose property has clearly been increased in market value by an improvement effected by local authorities, should specially contribute to the cost of the improvement."[2] Another official report deals specifically with "assessments according to benefits (betterment or amelioration)," and defines the custom as "assessment according to benefits, and the interception by charge upon property of a portion of the value added to such property by the expenditure of public money for improvement."[3] To all Americans it will be apparent at once that what we are dealing with is nothing but the system of special assessments.

[1] The Duke of Argyll, in a speech in the House of Lords, referred to it as an "absurd, foreign and vulgar" word. Mr. Baumann, on the other hand, says: "The word is respectable," but "the thing is not." Almost the only state in America where the term "betterment tax" is to be found is Massachusetts: and even this is true mainly of the earlier laws and cases.

[2] *Report from the Select Committee of the House of Lords on Town Improvements (Betterment)*, 1894.

[3] *Orange Book of the London County Council*, entitled *Precedents of Assessment according to Benefits*, 1893.

What appears almost self-evident to Americans is hotly disputed in England. In the United States the local taxes, so far as real estate is concerned, are imposed on the owner of the land; in England the local rates, as they are called, are levied on the occupier. In the United States the tax is assessed on all lands; in England it is assessed only on productive or rent-yielding land. In the United States, therefore, it was comparatively easy to add to the existing tax on the proprietor this newer system of charges; in England the process is more difficult, because it implies not only a change in the principle of charge, but also a change in the method of assessment. Not the occupier but the owner of the land, is to be directly reached. Thus the proposal, which in America is regarded as in harmony with vested interests, is viewed by its opponents in England as an attack on the rights of private property.

Yet, curious as it may seem, the levy of assessments for special benefits is an old English custom. In 1662,[1] an act was passed to authorize the widening of certain streets in Westminster and providing for the defrayal of the cost by voluntary subscriptions. In case this should not suffice, the commissioners to lay out the streets were empowered to charge the owners of the property in proportion to the benefits received.[2] The important clause reads:

[1] It is worthy of note that two cases on betterment, prior to the law of 1662 have been discovered. The first is the Romney Marsh case in 1250. This referred to the repair of sea-walls. The ordinance provided that the officials should "measure by acres all the lands and tenements which are subject to danger within said marsh" and then "having respect to the quantity of the walls, lands and tenements which are subject to peril . . . shall ordain how much appertaineth to every one to uphold and repair the same walls. *Cf.* Cannan, *History of Local Rates in England*, 1912, p. 11.

The second case is that of improving the rivers Lea and Thames in 1605. The law provides "for clearing the passage by water from London to . . . Oxford" and says: "For that it is reasonable, just and equal that those who partake in the benefit of any good work should in fit proportion contribute to the costs and charges thereof: . . . the commissioners . . . shall have power . . . to tax and assess . . . such of the inhabitants . . . as shall in their opinion be likely to receive ease or benefit by the said passage."

As to other alleged cases of precedents for betterment charges see *infra*, pp. 439–441. For the earlier Dutch precedent see *infra*, p. 436. Somewhat analogous was the mediæval *pavage* as found in Paris, *e. g.*, in the fourteenth century and later. *Cf.* M. G. Grandjean, *Obligations et taxes de pavage et trottoirs. Anciens usages, legislation, doctrine et jurisprudence actuelles.* Paris, 1919, esp. pp. 13 *et seq.*

[2] 13 and 14 Chas. II., chap. 2, sec. 29.

"And whereas, the houses that remain standing . . . will receive much advantage in the value of their rents by the liberty of ayr and free recourse for trade and other conveniences by such enlargement, it is enacted . . . that . . . a jury . . . shall . . . judge and assess upon the owners and occupiers of such houses, such competent sum or sums of money or annual rent, in consideration of such improvement and renovation as in reason and good conscience they shall judge and think fit."

Five years later a similar act was passed, to provide for the rebuilding of the city of London after the great fire. This contained an almost verbal repetition of the clause just cited. The changes were: first, that the charge was then to be made "in consideration of such improvement and melioration," instead of "improvement and renovation"; and, secondly, that, whereas the charge of 1662 was to be assessed on the "owners and occupiers," the new charge was to be levied on the "owners and others interested, of and in such houses," according to "their several interests."[1] That this law was not a mere dead letter is shown by a passage in *Pepys' Diary* where the actual operation of "the benefit of the melioration" is interestingly described.[2] Thus, over two hundred years ago the principle over which so earnest a contest is now being waged was in full operation and in the very city where it is vehemently assailed as an unjust system of foreign importation.

The law of 1667 is interesting in another respect. Not only were new streets to be laid out, but the commissioners were empowered to design and set out "the numbers and places for all common sewers, drains and vaults, and the order and manner of paving and pitching the streets and lanes within the said city or liberties thereof." Then follows the significant section:[3]—

"For the better effecting thereof, it shall . . . be lawful . . . to impose any reasonable tax upon all houses within the said city or liberties thereof, in proportion to the benefit they shall receive thereby, for and towards the new making, cutting, altering, enlarging, amending, cleansing, and scouring all and singular the said vaults, drains, sewers, pavements and pitching aforesaid."

Here not only is the word "benefit" used, but the charge is called a tax. Still more important is the fact that while the

[1] 18 and 19 Chas. II., chap. 18, sec. 24.

[2] *Pepys' Diary*, under date Dec. 3, 1667. The passage is quoted in the London County Council's *Orange Book of Precedents*, p. 37.

[3] 19 Chas. II., chap. 3, sec. 20.

custom itself seems to have died out in England, this act was the model upon which was framed the first law providing for special assessments in America. The province law of 1691 of New York [1] followed the act of 1667 almost word for word; and from New York, the custom later spread all over the United States. The system of special assessments or "betterment," although it fell into disuse in the country of its origin,[2] is thus primarily an English institution.

II. *Betterment and Taxation*

We now come to the question which really lies at the root of the whole controversy in England: Is the so-called "betterment tax" a true tax or "local rate"? What appears to be merely a question of terminology has led to a great deal of confusion. For if it is a tax or rate,[3] why should it be levied differently from other rates? And if it is not a tax or rate, under what authority can it be levied at all?

We must revert to what has already been said in a previous chapter, but it is necessary to discuss the subject somewhat more in detail.

As we have already seen, when the state makes the individual give up a part of his property, it does so primarily through the power of taxation, which in this wider sense denotes a forced contribution. Governments may levy, and have always levied,

[1] It is worthy of note, however, that we find two instances already in New Amsterdam in 1657 and 1660. The petition for paving the *Heere Graft* with stone asked "that each one benefitted shall be made to pay a proportion of the expense." See Paulding, *Affairs and Men of New Ams'erdam in the Time of Governor Stuyvesant*, 1843, pp. 14 and 16. Special assessments seem to have been fairly common in the towns of the Low Country. In Utrecht we find them in 1659 and 1661 under the name of Meliorations (*i. e.*, betterments). They can be traced back as far as the middle of the sixteenth century. In 1558 e. g., they were employed by the town of Alkmaar to improve the market place. Eberstadt, *Städlebau und Wohnungswesen in Holland*, 1912–14, vol. ii., 76 *et seq.*

[2] In England we find during the eighteenth century several paving acts applicable to London which levy the entire cost, or two-thirds of the cost, of the paving on the abutting property owners. *Cf.* Cannan, *op. cit.*, pp. 128–129.

[3] Cannan, *History of Local Rates in England*, p. 5, attempts to draw a distinction between rates and taxes when in reality he is merely distinguishing between apportioned and percentage taxes. He is forced to the rather absurd conclusion that the national land tax in England is a rate!

these forced contributions according to different principles—either that of benefit, or that of ability. They may say to the individual: We are performing a special service for you, and shall make you pay for this peculiar benefit which you derive; or they may say: we are expending certain moneys in the public interest, and shall ask you to pay your share, according to your means. The latter payment is called a tax in the narrower sense of the word. The question at once presents itself: Is not the former payment also a tax?

The difficulty here arises from confounding special with general benefits. The theory of benefits or of protection is true in the sense that if the government taxes the people, it is in duty bound to protect them and to confer upon them the advantages of good government. That is what is meant in America by the doctrine of "public purpose." Taxes must be used for public purposes, and must confer upon the public the usual benefits of government. But this is not the theory of benefit as the term is commonly employed. The theory of benefit claims that the government must give to each individual a return equivalent to the tax he has paid. If this means anything at all, it means that benefit and taxation are correlative. In this sense, the claim is unfounded; for the government, when it levies a tax, never guarantees to do a particular thing for the particular individual, or to confer upon him a special benefit. No one would be justified, legally or morally, in claiming a restitution of a tax because the action of the government was not worth quite so much to him as he thinks it is worth to his neighbor. The benefits of state action, for which a tax is paid, are quantitatively unmeasurable; or, so far as they may be measured, they accrue to the individual not as a special result, but as an incidental result, of his participation in the common weal. The benefits of the army, of the judicial system, of the consular and diplomatic service, and of all the other objects for which expenditures are made and taxes in general are levied, do not accrue to any one taxpayer more than to another. Even in local finance, where a general tax is levied to defray all the local expenditures, it cannot be maintained that the benefits arising from the action of the local judiciary, of the police, of the fire service, of the board of health, or of the other departments of local government are separately measurable for each individual. One may value the benefits greatly, while another may feel less interest in that particular branch of the administration; yet this cannot be per-

mitted to change the measure of their obligations to the government. Every member of the community for which these expenditures are made must contribute to these expenditures in proportion to his means to pay. If the government neglect its duty and fail in protecting his person from violence or his property from fire or from destruction, he may use his political rights in overturning or in improving the administration; but he has no shadow of a claim for a diminution of his tax rate. Protection and taxation, in this sense, are not correlative.

We have thus far been dealing with general taxes, whether federal, state or local. A general tax is a tax levied for general public purposes. But it may happen that government desires to raise money for some special purpose, and the tax is then called a special tax. Thus there may be a special tax levied upon the whole community to defray the cost of a war, or there may be a special local tax to defray the cost of some particular department. So, too, in a few of the American states, like New Jersey, we find not only a special school tax, but special taxes, of the same nature as the English local rates, for police or for lighting or for fire purposes. Here, indeed, a special section of the community is singled out; and one area is subject to the poor rate, while perhaps another is subject to the watching or the lighting rate. The charge, however, is still a tax, levied according to the generally recognized criterion of ability; for although the particular area which is benefited is put into a separate class, the benefits to the individuals of the class are general, not special, exclusive, or individual benefits. Although all the persons liable to this special tax are subject to the tax only because the section, as a whole, derives a benefit, yet each individual derives a benefit, if at all, simply as a member of the section; the government does not do any one particular thing for him, as apart from the other members of the section. The "rate" is a special tax as opposed to a general tax, because it defrays a special expenditure of government; but as to every one within the section, the tax is payable whether the particular individual receives much or little benefit.

In the poor rate, for instance, the original law expressly provided for assessments according to the ability of the parishioners, or, as it was subsequently expressed, *ad statum et facultates* of the inhabitants. The degree of benefit accruing to each ratepayer is immaterial; for the rate is levied on all the inhabitants according to the English test of ability to pay, which was origi-

nally general property, but which has since then been confined to productive real estate.

On this poor rate all the other local taxes, with only one or two exceptions, were built up. Of the church rate nothing more need be said, since it has always been imposed on the same principle as the poor rate.[1] The sewers rate was originally levied by a law of 1427, which, as well as its successor of 1531, does indeed speak of the benefits or advantages to be derived. Some recent writers have been misled by this statement into the belief that it is a precedent for the principle of betterment. A careful reading of the original acts, however, proves that the benefit is jurisdictional only, *i.e.* that a certain district is to be selected where the inhabitants derive a benefit from this governmental action, but that the rate or tax is to be assessed on each individual according to the quantity of his lands, irrespective of the degree of benefit conferred upon him.[2]

At that period the test of ability to pay was the quantity of land, but later the test became the rental value of the land. It has, moreover, been repeatedly decided that the sewers rate must be levied on the principle of ability, so that the official

[1] The church rate is said formerly to have been made by common estimation. "What principle this common estimation was founded on does not appear, but it was always undoubtedly in reference *ad statum et facultates*, that the burden was imposed." *Report of the Law Commissioners on Local Taxation*, 1843, 8vo edition, p. 43. *Cf. ibid.*, p. 22.

[2] The law of 1427 enjoins the commissioners "to enquire . . . by whose default such damages have there happened, and who doth hold lands and tenements, or hath any common of pasture or fishing in those parts, or else in any wise have, or may have, the defence, profit and safeguard, as well in peril nigh as from the same far off, by the walls, ditches, gutters, sewers, bridges, causeys and wears, and also hurt or commodity by the same trenches, and then to distrain all them for the quantity of their lands and tenements, either by the number of acres or by their plow lands, for the rate of the portion of their tenure, or for the quantity of their common of pasture or fishing, together with the bailiffs of liberties and other places of the county and places aforesaid." 6 Hen. VI., chap. 4.

The law then directs the commissioners to make, repair, or cleanse or stop up the trenches, *etc.*, "so that no tenants of lands or tenements . . . nor other of what condition, state or dignity, which have or may have defence, commodity and safeguard by the said walls, ditches, *etc.* . . . or else any hurt by the same trenches . . . shall in anywise be spared." *Ibid.*, chap. 5.

The law of 1531 contains almost the same words, and assesses the rate "after the quantity of their lands, tenements and rents, by the number of acres and purchase, after the rate of every person's portion, tenure or profit." 23 Hen. VIII., chap. v. There is no mention of any varying degree of benefit as the basis of the rate.

commission tells us that the sewers rate "is commonly imposed in exactly the same manner" as the poor rate.[1]

Even American commentators have been led astray by the example of the sewers rate.[2] It is true that landholders lying beyond the area in question cannot be taxed, because they do not belong to the class; but the essential point is that all the members of the class are taxed, not according to the benefits they receive, but according to their abilities. The official commission tells us explicitly: "It is an indispensable condition (of the sewers rate) that a person taxed may by possibility receive benefit from the expenditure of the tax, and therefore holders of mountainous or high ground which cannot be surrounded, are in general exempt. *Still, the exact measure of the benefit is not the measure of the liability to be taxed.*"[3]

[1] *Report of the Poor Law Commissioners on Local Taxation*, p. 22.

[2] Cooley, *Taxation*, chap. xx. Baumann, *Betterment* (1893), p. 6, correctly enough calls attention to this: "It is most important not to confuse rating zones . . . with betterment. All the individuals within a rating zone pay the same proportion irrespective of the *quantum* of benefit which each individual may receive. But the *quantum* of benefit received by the individual is the essence of betterment."

[3] *Report of the Poor Law Commissioners on Local Taxation*, p. 65. The statement in the text is strictly true of the ordinary sewers rate. Yet in more recent years there is an occasional instance of a charge under special sewers acts, where we find not only a separate area for the property benefited, but where it is permissible to levy a charge on each separate piece of land according to the benefits specially derived. These isolated examples would indeed be precedents for "betterment taxation" or assessment according to special benefit. So the Metropolitan Sewers Act of 1848 gave the commissioners power to levy the charge on the various "lands or tenements in proportion to the several lengths of frontage abutting on such sewer as aforesaid or when all the lands or tenements specially benefited or drained by such works, or when in any other case an assessment according to frontage shall appear to the commissioner inequitable, then in such proportion as the commissioner shall determine, such lands or tenements to be benefited by such work." 11 and 12 Vict., chap. cxii., sec. 81. This is quoted in the *Orange Book of the London County Council*. But the compiler, Mr. Charles Harrison, does not always adequately distinguish between such cases and many of the other so-called precedents, where the matter of benefit is jurisdictional only. He may have been led astray by the *Report of the Select Committee of the House of Lords on Conservancy Boards*, 1877, no. 371, which accepted the statement of one of the witnesses of "the principle introduced by the statute of Henry VIII., and observed ever since, of taxing in proportion to the benefit conferred in each particular case." See *Report*, vi. The statute of Henry VIII., as we now know, spoke only of a jurisdictional benefit.

As to the later sewer acts, it has been repeatedly decided that "if prop-

A possible approximation to the principle of benefits is found in the English lighting and watching rates, where a distinction is drawn between land proper and improved property, and where the occupiers of land pay only one-third as much as the occupiers of houses and other buildings.[1] Whether this act really had in mind the question of benefit at all is doubtful. The question assuredly played no rôle in the adoption of the present rule under which the ordinary poor rate is charged upon only one-half of the rateable value of land. Even if the matter of benefit was considered in the lighting and watching rate act, it must be remembered that here there are still only two classes—lands and improvements—and that the charge upon the individual occupier is not proportioned to the special benefits he receives;

erty is situate within the area benefited by the sewers, it must contribute without any reference to the amount of benefit derived." See Reg. *vs.* Head, 3 B. & S. 419; 32 L. J. M. C. 115; 9 Jur. (N. S.) 871; 8 L. T. 708; 11 W. R. 339. *Cf.* Boyle and Davies, *The Principles of Rating practically considered*, 1890, p. 426. *Cf.* A. Crew, *Rates and Rating*, 1924.

Mr. Edwin Cannan, in his book mentioned above, which appeared since the above was originally published, seems to be guilty of the same confusion. In fact, he goes even further and seems to posit the benefit principle (betterment) and the ability principle as two contrasted, but historically almost equally valid bases of local taxation. *Cf. The History of Local Rates in England*, p. 50. As a matter of fact, however, with only two exceptions noted *supra*, p. 434, every one of the instances of so-called benefit rates which he adduces is an example only of jurisdictional benefit. Thus the act providing for the rebuilding of the Scarboro pier in 1546, printed in full in Cannan, pp. 35–37, mentions only that if the pier were so repaired, all the lands and houses within the precincts of the town "might be set or letten for much greater rents or farms," and then proceeds to levy one-fifth of the rents on all owners irrespective of whether the particular rent was increased or not. The next case, the act of 1566 for the preservation of grain (*op. cit.*, pp. 41–42), levies a tax on all lands according to quantity, to defray the expense of exterminating birds and vermin, irrespective of whether the particular piece of land was benefited or not. So the act of 1555 for re-edifying forts in Scotland (*ibid.*) taxes all property owners in the four counties according to the size of their estates, their profits, or "other commodities there." The few remaining cases mentioned by Cannan cannot even remotely be regarded as betterment rates.

If the distinction between a special benefit and a jurisdictional benefit is borne in mind, and if, as is proper, the term "benefit principle" is reserved for the former, it will be realized that to put the benefit principle on an alleged equality with the ability principle in local taxation as Mr. Cannan does is to present a distorted view of the real state of affairs. Hallgarten, *Die kommunale Besteuerung des unverdienten Wertzuwachses in England*, Stuttgart, 1906, pp. 46–47, accepts my position.

[1] Lighting and Watching Act of 1833. See also 18 and 19 Vict., chap. 120, sec. 165.

he is thrown into a general class with all others in the same category, and within this category every one pays according to his ability.[1] The lighting and watching act, however, being optional, is now in force only in a few hundred rural parishes, which have adopted it; and in most cases, as well as in all urban parishes, the lighting and watching rates, like all the other English local rates, are at present commonly levied in exactly the same manner as the poor rate—that is, according to the ability of the rate-payer.[2]

The English rates are thus nothing but taxes—special taxes, it is true, but levied according to the principle of all direct taxa-

[1] This is overlooked by Mr. Harrison in his collection of precedents in the *Orange Book*.

[2] "All these legal varieties are disregarded in practice," and the rates are made "on the same persons, on the same basis, and by the same scale as the poor's rate." *Report of the Poor Law Commissioners on Local Taxation*, pp. 65, 67. The only exception to the rule that all local rates are assimilated to the poor rate is at present (1912) in addition to the lighting rate (for watching is of course obsolete since the advent of the police system), the sanitary rates, which are legally chargeable on agricultural land, railways, *etc.*, at one-fourth only of the rateable value.

While the above-mentioned report is exceedingly valuable for its facts, it is sometimes confused in its economics. Thus we find the following passage:—

"For any system of taxation to be fair, it must bear a proportion both to the benefit conferred upon the taxpayers by the expenditure of the tax and to the means which the person possesses of paying the tax. It is, however, in all cases found to involve insuperable practical difficulties to combine both these conditions in the imposition of a tax, and it seems most usual to assume that the benefit derived is in proportion to the ability to pay, or that the ability to pay is in proportion to the benefit derived. *In most of the local taxes the ability to pay is the standard of taxation.* In some, however, where the taxpayer has a definable share of the benefit of the expenditure, the proportion of the benefit enjoyed is made the standard of taxation. In other cases both principles are attempted to be combined," p. 43.

As a matter of fact, the only examples of "benefit" adduced by the commission are the sewers rate and the lighting and watching rate. In the former the assessment by acreage is assumed by the commissioners to represent the principle of benefit; the assessment according to "profitableness," the principle of ability. This is a mistake, because, as we have seen, taxation of land by mere quantity was at one time everywhere the test of ability. In the lighting and watching rate "both principles," we are told, "are adopted, though very clumsily and inadequately." As has been explained, however, in the text, there is no question here of assessment according to special benefits to particular individuals. Thus the only examples adduced by the commission admit of a different interpretation, and the commission itself states "that the whole of our local taxation is imposed either by law, or by usages regardless of the law, on the same basis as the poor's rate."

tion, on faculty or ability to pay. Whether the local expenditure is defrayed by one general tax, as in some counties, or by a number of special taxes, as in England, is immaterial—in each case we are dealing with a tax proper.[1]

But when we leave the principle of ability—as measured by property or by rental value or by any other test—and come to a payment which differs in each particular case, and which is proportioned to the special or exclusive benefit accruing to the particular individual, it is apparent that we are dealing with a very different kind of charge. Instead of the principle of faculty, we now have the principle of equivalents. The charge is not a rate or tax except in the wider sense that every compulsory charge levied by government may be called a tax, because it can be imposed only by virtue of the power of taxation. As we have seen above, however, the taxing power may manifest itself in different forms; a local rate is an example of one form, a highway toll or a cab license fee of another, a betterment charge of still another. Few Englishmen would say that a highway toll or a cab license is a rate or tax; yet a toll and a tax differ from each other scarcely more than do a local rate and a betterment charge. A local rate is levied for the purposes of the whole community or of a definite class of the community, according to the principle of capacity or ability to pay; a highway toll or a cab license fee or a betterment charge is imposed on particular persons for special benefits accruing to the individual as such.

Thus the problem is solved. A betterment charge (or special assessment) is at once a tax and not a tax. It is a tax in the sense that all compulsory charges are taxes, because they are imposed by the taxing power of government. But it is not a tax in the narrower and common sense of the term. It is not a tax in the sense that the income tax or the house duty is a tax; it is not a tax in the sense that a local rate is a tax; it is just as much or as little of a tax as a marriage license fee. If we persist in employing the term *tax* for all manifestations of the taxing power, it will be necessary to coin a new word for taxes

[1] Professor Bastable, *Public Finance*, p. 364, thus errs in stating that the English local rates are "measured for each payer by the benefit of the service," and that "local taxation should be in proportion to advantage." In Rex *vs.* Mast, 6 T. R. 154, the principle of local taxation is laid down that "each inhabitant should contribute according to his ability, which is to be ascertained by his possessions in the parish." *Cf.* also Boyle and Davies, *op. cit.*, p. 99.

in the narrower sense, as distinguished from fees and special assessments. It is the thing, not the name, that is important; and the confusion has arisen simply from the fact that we employ the same term, sometimes for the one conception, sometimes for the other. Much trouble would be avoided if the payment were called simply a betterment charge or a special assessment, as opposed to a local rate or tax.[1]

III. *The Principle*

The theory of the betterment charge or assessment according to benefits is very simple. It rests upon the almost axiomatic principle that if the government by some positive action confers upon an individual a particular measurable advantage, it is only fair to the community that he should pay for it. The facts may be in question, for it may happen that the particular advantage is only ostensible, or that the special benefit is not measurable. But the facts being given, the principle seems self-evident.

In our discussion of the single tax, it was pointed out that there is a distinction between unearned increment in general and the betterment principle in particular. The single tax on land values was found to be inequitable because benefit is not

[1] The entire contention of Baumann, *Betterment, Worsement, Recoupment* (1894), p. 36, in opposition to Mr. Harrison's statement that betterment in the United States has been decided not to be taxation, rests on a failure to observe the distinction made in the text. "Special assessments" may indeed be "an exercise of the taxing power"; and yet "betterment" is not necessarily the same thing as "taxation." So also Mr. Baumann's criticism of Mr. Cripps' distinction (pp. 39–40) rests on a complete misconception.

This is a convenient place to call attention to the errors in Mr. Baumann's earlier book, *Betterment* (1893). He entirely misunderstands Judge Cooley in imagining that that author condemns the practice of estimating the benefits accruing to each lot separately. As Mr. Rosewater points out in the *Political Science Quarterly*, viii., p. 764, what Judge Cooley really disapproves, and what is now quite generally held to be unconstitutional, is the practice of charging upon the abutting owner the cost of the particular improvement in front of his lot only, without reference to the benefits along the whole line of the work—in fact, without apportionment. From this misconception, Mr. Baumann has fallen into grievous error. He also fails to distinguish the safeguards thrown about the exercise of eminent domain in the American commonwealths from the procedure required in levying special assessments. It is, in most cases, merely an accident that the proceedings for the two operations happen to be joined together.

There are many other mistakes in the volume, as, for instance, the state-

the general principle of taxation, and because, even if it were, it would not mean a single tax. The benefits of general governmental action are quantitatively unmeasurable; we do not, by paying taxes, purchase a definite amount of advantages from the government as we buy a certain quantity of tea from the grocer. But if the government performs some special service for us, there is no reason why the public at large should pay for it: to the extent that the community as a whole is interested in the service, it is proper that it should contribute to the expense. If it is wholly a matter of common interest, the community should pay all; if it is wholly a matter of individual benefit, the individual should pay all; if it is partly common and partly individual, the cost should be divided and the individual should pay up to the amount of his measurable special benefit. In the one case, the expense is met by a tax or rate; in the second, by a fee or toll, or by a special assessment or betterment charge; in the third, by a combination of both methods. To object to a betterment charge because it is not levied according to the principle of ability to pay is as illogical as to object to a tax because it is not levied according to the special advantage derived. We must not apply to one principle of public contribution the test peculiar to another principle.

When, therefore, the local government performs a definite act and makes a definite expenditure the result of which is a clear and measurable accretion to the value of some particular piece of property, every consideration of logic and justice demands a special contribution by the owner to defray this expenditure.

As a principle, this is really no longer debatable. Even so conservative a body as the Committee of the English House of Lords, after hearing all the arguments in opposition, has recently come to the conclusion that—

"The principle of betterment—in other words, the principle that persons whose property has clearly been increased in market value by an improvement effected by local authorities should specially contrib-

ment that special assessments are unconstitutional in Minnesota (p. 75); that their constitutionality is still doubtful in Illinois (p. 76); that Adam Smith lays down value as the only standard by which taxes can be apportioned (p. 81); and that American judges allow special assessments for benefit with reluctance (p. 100). On p. 80 we find the same confusion as that alluded to above in the later work. Most of the objections in this later book are too frivolous to deserve any reply.

ute to the cost of the improvement—is not in itself unjust, and such persons can equitably be required to do so.[1]

This concession practically marks the close of the contest on the question of principle, in England. The methods of carrying out the principle are indeed debatable; but in its broad lines, the theory is now accepted in the chief quarter where opposition could be expected.[2]

A subject much discussed in connection with betterment is that of "worsement." If an individual has to pay for a benefit, it was claimed that his neighbor should be recompensed for damages to his property, caused by a public improvement. The committee, however, decided that injury to property was to be taken into account only when a betterment charge was imposed upon the same owner for benefits accruing to his property in the immediate neighborhood, by the very same improvement. Further than this it was unwilling to go. As it has been well said, it is nothing less than a grotesque absurdity to suggest the creation of new vested interests in the perpetuation of such public evils as overcrowded and insanitary slums and in circuitous modes of communication.[3] In the Tower Bridge Act of 1895, as well as in the Standing Orders of the House of Lords adopted in July, 1895, the legitimacy of "worsement" has been recognized, but only within the above very narrow limits.

A plan sometimes urged as calculated to attain the same results as the betterment system is that of "recoupment." It has occurred that in making an improvement the municipal government or other public body has taken more land than was actually necessary, and after the execution of the work

[1] *Report of the Select Committee on Town Improvements*, 1894, p. iii.

[2] The legislative history of betterment in England is interesting. The first bill was the Strand Improvement bill of 1890, in which the betterment provisions inserted by the London County Council, and adopted in the chairman's draft report, were struck out by the Select Committee of the House of Commons. The next was the Cromwell Road Bridge bill of 1892, in which the betterment clause was struck out by the committee by a majority of one. Then came the London Improvements bill of 1893, providing for a new central street from the Strand to Holborn. This passed the House of Commons but was defeated in the House of Lords' committee. Finally came the Tower Bridge Southern Approach bill of 1894, which after various mutations was approved by the House of Lords' committee, and became law in 1895, as 58 and 59 Vict., ch. cxxx. In this act the payment is termed an "improvement charge."

[3] G. H. Blunden, *Local Taxation and Finance*, 1895, p. 95.

has sold the land at a higher price, thus retaining for the community the increment in value. In was shown by the testimony before the Lords' committee that, as a matter of fact, these transactions had generally resulted in loss rather than in gain; but it was claimed that this was due in large part to certain defects in the law. The committee reported itself "as not satisfied that it has ever been tried under circumstances calculated to make it successful."[1] Subsequent experience with the principle, however, has proved to be far more satisfactory and the recent successful application of the principle in the construction of the Kings Highway in London and in various other notable improvements has thus paved the way for what is now being strongly urged in many American states under the name of "excess condemnation."[2]

It is evident, however, that the real difficulty with betterment lies in the details of its execution. In the United States, where the system has for a long time been thoroughly at home, it has been deemed sufficient to approximate roughly to the benefits conferred. In no department of public contribution is it ever possible to gauge with precision the exact relation of the individual to the public purse. With special assessments, as with other operations of public finance, the best that governments can do is to reach substantial justice. The decision is left to the legally constituted authorities, and the assumed benefit, which is to guide the authorities in their decision, is not always necessarily the exact actual benefit, a fair approximation to the real benefit being now considered adequate for practical purposes. This result, however, has been reached only after considerable experience.

In England, on the other hand, where the principle has only recently been introduced, far more solicitude is shown, because the opposition of the vested interests is naturally stronger. The committee recommended certain rules, most of which have been incorporated into the Tower Bridge Act of 1895, which are intended to limit the charge to the amount of actual benefit, and to protect the owner against any possible abuse of the system.

[1] "No sufficient power has ever yet been given to the local authorities to become possessed of the improved properties without buying out all the trade interests—a course which is inevitably attended with wasteful and extravagant expenditure." *Report*, no. 10 (of recommendations).

[2] This principle was adopted by constitutional amendment in Ohio in 1912.

He must be notified not only of the proposed charge before the commencement of the projected improvement, but also of the alleged increase in the value of his property within some reasonable period after the completion of the work.[1] Furthermore, if the owner objects, the matter is to be decided by an arbitrator or a jury, the costs being borne in general by the local authority. Finally, if the owner still thinks that the charge exceeds the enhancement of value to his property, he may demand that the local authority purchase the property at its market value.[2]

These provisions are interesting, the last being almost identical with the provisions of the recent New Zealand law explained in another chapter. In New Zealand, it is applied to progressive taxation; in England, it is recommended for the betterment charge. In each case it is simply a protection of the individual against arbitrary administrative action. The other provision as to costs seems to be a little unfair to the government, as it puts a premium on litigation and is calculated to interfere with the prompt completion of the work. All these points are, however, matters of detail which can easily be adjusted.

The Tower Bridge Act of 1895 was the first of the new English laws to incorporate the betterment principle. A few years later the same principle was recognized in the London County Council Improvements Act of 1897,[3] followed by a similar act in 1899.[4] In fact between 1895 and 1902 there were no less than nine London County Council Improvements acts which provided for betterment charges. But from then to the end of the decade the pace seems to have slackened and we find no more improvement acts at all. In 1909–1910, for instance, the receipts from betterment charges in the budget of the London County Council amounted only to the paltry sum of £395 out of a total revenue of £11,988,699.[5] The system seems, however, to be making its way slowly throughout the

[1] "The period should not be so short that the effect of the improvement could not be adequately tested, and it should not be so long as to make the property intended to be charged suffer in its market value by the suspension of the decision as to the charge." *Report*, no. 3. In the Act of 1895 the limits are twelve months and three years. 58 and 59 Vict., ch. cxxx., sec. 36 (4).

[2] *Report*, no. 7. The clause as adopted in the Act of 1895, sec. 36 (9), provides that the option of selling must be exercised *before* the arbitration.

[3] 60 and 61 Vict. ch. ccxlii., sec. 42.

[4] 62 and 63 Vict. ch. cclxvi.

[5] *London Statistics*, *1910–1911*, vol. 21, p. 413.

country, for the Housing and Town Planning Act of 1909 which is of general application, contains the following clause:

"Where by the making of any town planning scheme any property is increased in value, the responsible authorities, if they make a claim for the purpose within the time (if any) limited by the scheme . . . shall be entitled to recover from any person whose property is so increased in value one-half of the amount of that increase." [1]

Allowance, moreover, is made for this in the new land value taxes referred to below,[2] by the following provision: "When any capital sum or any instalment of a capital sum has been paid to any rating authority in respect to the increased or enhanced value of any land due to any improvements made or other action taken by the authority, the amount of that capital sum shall be deducted" in estimating the increment value duty or site value duty or reversion duty.[3]

The benefit principle, even though it is not applicable to taxation proper, has thus its undoubted place in the sphere of local revenue. That it is liable to abuse may be conceded; [4] but so is the principle of ability to pay. Taxes, like special assessments, have not always been levied with perfect fairness; but the departure from fairness must in these two cases be measured by entirely different standards. The system of special assessments, as has already been pointed out,[5] embodies a part at least of the truth in the unlearned increment doctrine. Dr. Rosewater puts the point admirably as follows: [6] —

"Special assessment undoubtedly transforms a certain part of the enhancement of land values from an unearned increment into an earned increment. It does this at the very time that the benefit arises, thus avoiding every taint of confiscation of vested interests. Through it may be secured the chief advantages of the appropriation of the future unearned increment, without destroying the healthful stimulus arising from the private ownership of landed property. The total increase

[1] Ed. VII., ch. xliv., sec. 58, subsec. (3).

[2] *Cf. infra.* chap. xvii.

[3] *The Finance (1909–1910) Act, 1910,* 10 Ed. VII., ch. viii., sec. 36.

[4] For a history of these abuses, see Rosewater, *Special Assessments*, chap. iii.; also *ibid.*, pp. 142–144.

[5] George A. Black, *The History of the Municipal Ownership of Land on Manhattan Island*, p. 78. Columbia University Studies in History, Economics and Public Law, vol. i., no. 3.

[6] Rosewater, *Special Assessments*, p. 140. *Cf.* the articles on "The Betterment Tax," by the Duke of Argyll and by John Rae, in *Contemporary Review*, vols. lvii. and lviii.

is seldom appropriated, but only so much as is required to defray that share of the cost of the particular improvement which may represent the special benefit conferred. We have here no uncharitable begrudging of all rise in value due to conditions other than those created by the party who reaps the advantage. All that is demanded is that when a person secures an enrichment to his estate, and the expense, if not borne by him, must be borne by some one,—in this instance, the tax-paying public—he shall make compensation therefor. This is the true equitable principle. The contributor pays not alone because he obtains a benefit, but because that benefit is joined to an expense the burden of which finds a fitter resting place upon his shoulders, than upon the shoulders of others not specially benefited."

In the United States the betterment principle has long been firmly rooted in the revenue system; and although there may be particular cases in which it has not worked well, the evidence of experience and the popular verdict as to the methods employed are overwhelmingly in its favor. On the continent of Europe the system is now fast spreading because of the growing importance of municipal finance and of the more careful analysis of its underlying principles. England, which has taken the lead in the reform of the national fiscal system, cannot afford much longer to lag behind in the movement for the just distribution of local burdens. Without the application of the betterment principle, such justice can scarcely be secured.

CHAPTER XVI

RECENT REFORMS IN TAXATION. I. THE REFORMS OF 1893–1895

INDUSTRIAL democracy is responsible for many changes, but few are more significant than those effected in the fiscal methods of recent times. In framing these newer systems modern nations have been confronted by two fundamental problems. The first is that of bringing about greater justice in distributing the weight of taxation among different classes of the community; the second is that of correctly apportioning the burdens among the various spheres of government.

The second problem, although of less importance in national than in federal states, has everywhere attracted an increasing amount of attention, owing to the demands made by industrial life upon political organizations, and to the growing complexity in the relations between co-ordinate and subordinate governments. In former times, when local expenditures were insignificant, and when the geographical aspect of industrial relations was simple in the extreme, the question of the due apportionment of public revenues among independent or overlapping jurisdictions scarcely existed.

Important though this be, the growth of industrial democracy has brought into still more prominent relief the difficulties of the first problem. Revenue methods, as they came down to us from bygone centuries, were defective in one of two ways. In some cases they were simply survivals of a system originally just, but which was calculated for more or less primitive economic conditions, or at all events for an economic life which, whether primitive or not, was fundamentally different from that of modern industrial society. Since political conditions, and therefore fiscal measures, depend in last resort largely on social and economic relations, it was but natural that the revenue system should become antiquated, and that what was conceived in justice should ripen into practical injustice. In many places to-day the fiscal demands of the new social democracy are legiti-

mate protests against the continuance of mediæval survivals in modern life.

In other cases, revenue systems were painfully lacking in another way. It is unfortunately true that the dominant social class has often succeeded in strengthening its hold by thoroughly selfish fiscal expedients. In such cases there was no pretence of equity even in the original imposition of the system. It did not need to grow bad, because it was bad from the very start; it was based not on justice, but on might. With the growth of industrial democracy, however, the maintenance of the old-time abuses became increasingly difficult; one by one they were recognized as such, to be lopped off at the first opportunity. In order to establish the long-delayed equities, it was necessary not only to pull down but to build up. Some, at least, of the recent changes which in themselves seem extremely radical, will therefore appear less extreme when regarded as parts of a larger whole—as a sort of compensation for what there is still left of injustice in existing systems.

Thus it is that tax reform is everywhere in the air. Demanded in some countries because of the divergence between economic conditions and fiscal methods, it is urged in others as a concession to those who have hitherto had less than justice. In both cases it is a product of modern industry and of modern democracy.

In this chapter it is proposed to call attention to the great changes introduced toward the close of the nineteenth century in such widely different countries as England and Holland, New Zealand and Prussia—changes, all of them effected within a period of scarcely more than twelve months, and springing from the same general desire to realize the principles of justice in the relation of the citizen to the public purse.

I. *England*

As in so many other domains of political science, England has here again taken the lead. The English are not much given to abstract reasoning in politics; but in the practical working out of political ideals, England has usually led the way. In finance she has taken a similar lead. She was the first important nation to restrict the scope of taxes on consumption and to introduce the income tax; and during the nineties, while scientists the world over were debating the problem of lessening the burdens on the lower and middle classes, she boldly took steps which in many other countries would, to say the least,

have been deemed premature. The three great reforms accomplished in England in 1894 were the extension of the inheritance tax, the introduction of the progressive principle, and the increase of the minimum of subsistence. Let us discuss these in turn.

The principle of the inheritance tax was not new in England; but its application had hitherto been very unsatisfactory. What are generally called the death duties were until the recent change composed of the following elements: (1) probate duty, a tax of about three per cent on personal property passing by will or intestacy; (2) account duty, a similar tax on gifts of personalty; (3) legacy duty, practically a tax on collateral successions to personalty, graded according to relationship; (4) succession duty, as altered in 1888, a tax on realty, settled personalty and leaseholds, with higher rates for collaterals than for lineals; (5) estate duty, an additional tax, since 1889, of one per cent on all estates, real and personal, over £10,000. These five taxes really consisted of two classes: the one, represented by the probate duty, being a tax on the total amount of the property, irrespective of the manner in which it was divided, or of the persons to whom it went; the other, represented by the legacy and succession duties, being a tax not on the body of the estate, but on the separate shares received by collaterals and outsiders. These five taxes constituted a complex whole, bristling with anomalies and inequalities, of which the most important was the distinction made between realty and personalty, the latter not only being taxed more heavily, but being subject to more complicated and burdensome rules. The act of 1894 [1] endeavored to remove these inequalities by imposing, in lieu of most of the previously existing taxes, a new estate duty.

This estate duty is a tax on the capital value of all property, real or personal, which passes on the death of any person. The taxes abolished are the probate duty, the account duty, the estate duty of 1889, the succession duty on lineals and the additional succession duty of 1888, all of which merged into the new estate duty. The only old duties which continued were, as we shall explain in a moment, the legacy duty, and, in certain cases, the succession duty.

Under the former system personal property was rated at its

[1] The Finance Act, 1894, 57 and 58 Vict. ch. 30. *Cf.* A. T. Layton, *The Finance Act, 1894, in relation to the New Estate Duties, with introduction and explanation.* See also *Table of Income Tax imposed by the Finance Act, 1894, with full text of act relating to Income Tax and notes of explanation.*

capital value, but realty was estimated at a fictitious sum according to the annual value and the varying degrees of interest in the property. In some cases the tax was charged only on the value of a life interest in the property; and where there was no annual value, as in the case of lands held for speculation, there was no tax at all. All these differences were removed by the new tax, which is levied on the market value of the property. In the same way the tax on realty could formerly be paid in instalments, while that on personalty was paid in a lump sum; but now, in order to equalize the taxes, interest is charged on the amounts remaining due until the final instalment is paid. Again, whereas formerly the instalments payable on realty lapsed with the death of the person primarily liable, they are now a charge on the estate and cannot be avoided. Finally, the tax applies to all death-bed gifts, which are defined to comprise any gift of realty or personalty made within twelve months of death.

It is somewhat confusing to find side by side with this estate duty a so-called settlement estate duty; but the explanation is simple. It is a common practice in England to tie up property by means of settlements, so that the beneficiary is not at liberty to dispose of the property itself, but enjoys only some interest in it, whether for life or for a term of years. It is readily perceived that, if each beneficiary were called upon to pay the tax on the total value of the estate, an injustice would result, especially if there should be more than one devolution under the same settlement. It is therefore provided in the new law that the estate duty shall be payable only once on the value of the property, which shall then be exempt from further payment during the continuance of the settlement. In consideration of this exemption and in order to obviate in part any diminution in the total yield, an additional tax of one per cent, called the settlement estate duty, is imposed on the principal value of the property so settled. An exception is made in the case of husbands and wives; and it is further provided that the additional duty shall not be payable more than once during the continuance of the settlement.

Another point worth mention involves the question of double taxation. In the original draft it was proposed to tax the property, wherever situated, of a person domiciled in Great Britain. It was pointed out, however, that this might involve double taxation where the foreign country itself imposed an inheritance tax on the property lying within its borders. The

bill was, therefore, amended so as to permit the amount of the foreign tax to be deducted from the sum payable by the estate in England. This is a simple solution of the question. It may also be added that the tax does not apply to property left to the central or local governments, to universities, to certain pensions, or to single annuities not exceeding £25.

The most significant feature of the new estate duty was the final acceptance of the graduated scale or the system of progressive taxation. Under the preceding laws there was indeed an exemption for very small sums; but that did not mean progressive taxation proper. In the law of 1894 the tax began with a rate of one per cent and increased in twelve successive stages until it reached eight per cent. Estates under £100 were not taxed at all; from £100 to £500 the rate was one per cent, but so arranged that estates under £300 made a fixed payment of 30*s.*, while estates between £300 and £500 were charged a fixed sum of 50*s.* Obviously the rate was more than one per cent on the lower figures of each class. Above £500 the rate increased until the maximum rate was reached at estates over one million pounds.[1] Even these figures do not adequately represent the real charge; for it must be remembered that, in addition to this new estate duty, there still exist a legacy duty and a succession duty. The legacy duty is a tax at the rate of three, five, six and ten per cent, graded according to relationship on personal property going to collaterals. The succession duty as changed by the same law [2] is a similar tax

[1] The exact figures are:—

Over	£ 100	to	£ 500	1%
"	500	"	1,000	2%
"	1,000	"	10,000	3%
"	10,000	"	25,000	4%
"	25,000	"	50,000	4½%
"	50,000	"	75,000	5%
"	75,000	"	100,000	5½%
"	100,000	"	150,000	6%
"	150,000	"	250,000	6½%
"	250,000	"	500,000	7%
"	500,000	"	1,000,000	7½%
"	1,000,000			8%

[2] Under the original law, the rates were as follows:—

Lineal issue and ancestors	1%
Brothers and sisters and their descendants	3%
Uncles and aunts	5%
Great uncles and aunts	6%
Other persons	10%

applicable to realty. The two duties together form a collateral inheritance tax, which must be paid in addition to the estate duty, with the important exception that estates not exceeding £1,000 are subject only to the latter. The net result is that in the law of 1894 the rate of inheritance tax varied from one to eighteen per cent of the value of the property.

These are remarkable figures, considerably exceeding those to be found at that time in any other important country.[1] When almost one-fifth of the property is taken by the state, as is the case with large fortunes going to outsiders, we are approaching Bentham's principle of escheat. Compared to the paltry amounts levied by inheritance taxes in America at that time, the English figures are certainly striking. The introduction of the progressive principle was indeed hotly opposed, and the cry of socialism was raised, but all in vain; for the Chancellor of the Exchequer regarded the principle of progression as firmly established by the weight of recent economic authority. He even went so far as to say that it was equally applicable in principle to the income tax, and that the sole reason for his not introducing it there was of an administrative nature.[2] The definite acceptance of the progressive principle in English politics marks a most important step in the history of public finance.[3]

Side by side with this extension of the principle of ability to pay, went its enlargement in another direction. Under the inheritance tax the large amounts have to pay increased

But as lineal issue and ancestors were exempted when the property paid probate duty, so the exemption now continues, since the new estate duty replaces the old probate duty. The succession was levied at a higher rate, and under different conditions; but it is now exactly the same as the legacy duty. They are maintained as separate duties simply because of the body of legal decisions that has grown around them.

[1] In some of the Australian colonies the rates were slightly higher. In Victoria estates of £100,000 paid ten per cent direct tax; and in Queensland the highest rate for collaterals was twenty per cent. The Swiss canton of Uri went even higher.

[2] In answer to the question why the income tax should not be graduated, he replied: "In principle there is nothing to be said against such a system; indeed there is every argument in its favor. The difficulties which lie in its way are of an administrative and a practical nature, which as yet I have not been able to find means to overcome."—*Budget Speech, April 16, 1894,* Hansard, p. 502.

[3] The fear that the new tax portended a breaking up of the large landed estates turned out to be groundless. The lawyers soon devised schemes of settlement which succeeded, in part, at least, in mitigating the rigor of the law.

rates; in the income tax, where this was deemed impracticable, a somewhat similar result was reached by making the smaller amounts pay decreased rates. As a result of successive changes, the tax had been so arranged that incomes below £150 were entirely exempt, while incomes between £150 and £400 received an abatement of £120. Under the new law the desire to ease the burdens on the lower classes resulted not only in an increase of the total exemption, but in an addition to the abatements and in an enlargement of the classes to which abatement is accorded. The limit of total exemption was now fixed at £160; incomes between £160 and £400 received an abatement of £160; while incomes between £400 and £500 were permitted to deduct £100. To use technical language, while the progressive principle was introduced in the inheritance tax, the degressive principle was extended in the income tax. Both are manifestations of the idea of graduation, according to the doctrine of faculty in taxation.[1]

One other change deserves mention. The landowners made a strenuous opposition to the equalization of the "death duties," maintaining that real estate already paid more than its share in the shape of local rates. To this objection two arguments were opposed. In the first place it was by no means proved that the weight of the local taxes rests on the landowners. Not only were the taxes levied on the occupier, so that the incidence was only partly, if at all, on the owner; but the landowner was largely exempt from what are known in America as special assessments. Secondly, it was contended that there would be a better prospect of securing an equitable system of taxation if each tax were made just in itself, without regard to the others. Yet attention was so far paid to the cry raised by the landowners as to lead the government to diminish the burden of the income tax resting on them. It had long been a complaint that real estate was assessed in schedule A at its gross income, not at its net income, thus not permitting deductions for repairs. Under the new act the assessment may

[1] A few years later, namely in 1898, this principle was still further extended. The abatements on incomes below £400 remained the same, but on incomes from £400–500 the abatement was increased from £100 to £150; and two new grades were introduced, incomes between £500–600 enjoying an abatement of £120, and incomes between £600 and £700 receiving an abatement of £100.

be reduced by one-eighth in the case of farms, and by one-sixth in the case of other buildings. This is at once a substantial concession to the landowners, and a decided improvement in the theory of the tax itself. But the change in schedule A and the great extension of the exemption and abatements promised so materially to diminish the yield that it was deemed necessary to increase the rate from sevenpence in the pound, or less than three per cent, at which it had stood some time, to eightpence, or three and one-third per cent.

Finally, attention must be called to the provisions affecting the relation between local and national revenues. For some time there has been growing dissatisfaction with the burden of local taxation. Beginning in the thirties an attempt was made to remove this in part by the device of grants-in-aid, or subsidies from the general government to the local bodies, which were increased from time to time.[1] In 1888, Mr. Goschen altered the arrangement by allotting to the local bodies certain definite revenues hitherto accruing to the imperial government. These consisted of the greater part of the excise licenses, henceforth known as local taxation licenses, and in addition one-half of the probate duty as then levied. The law of 1894 virtually maintained this arrangement by appropriating out of the new estate duty to the reduction of local taxation a sum of one and one-half per cent on the net value of the property which, but for the substitution of estate duty, would have been chargeable with probate duty. Sir William Harcourt made no attempt, however, to reconsider the whole question of the relation between general and local taxes, but expressly left it open for future discussion. Further consideration of this point—perhaps the only important point in which the English system is still defective—cannot much longer be delayed.

It may be interesting to note the financial results of these measures. While the income tax at the old figures was estimated to produce slightly over fifteen millions sterling, the increase of rate was almost counterbalanced by the changes above alluded to. Thus while in 1894 the yield with a 7*d.* rate was £15,337,000, in 1895 with an 8*d.* rate the yield was only £15,856,000. On the other hand, whereas the "death duties" had been yielding about £10,000,000, the new system con-

[1] For a detailed history of these see Grice, *National and Local Finance*, London, 1911. *Cf.* also Sidney Webb, *Grants in Aid*, 1911.

siderably increased the yield, so that in 1895–96 the revenue amounted to over fourteen millions sterling. As, however, about two and a half millions went to the reduction of local taxation, the net increase to the imperial treasury was not very great. The new measures were, therefore, intended not so much to produce more revenue as to introduce more justice and to equalize the burdens on the various classes of taxpayers.

The new budget thus marked a turning-point in English finance, and proved itself very popular.[1] To have swept away the anomalies of a great system of taxation, to have definitely introduced the principle of progression, to have removed inequalities in the income tax, and to have greatly increased the minimum of exemption,—these are achievements on which any finance minister might pride himself. The name of Sir William Harcourt, it may safely be affirmed, will not be forgotten in the annals of British finance.

II. *New Zealand*

While England was battling with these problems, a similar movement was going on at the antipodes.[2] In New Zealand, as in all early communities, the original source of revenue was the general property tax. But this, having obviously become unsuitable to modern conditions, was modified in several directions. The three important changes in the early nineties were the enactment of the income tax, the adoption of the system of graduation, and the exemption of improvements from the land tax.

The first step in the movement was the passage of "The Land and Income Assessment" act of 1891.[3] A tax on land values had been imposed as far back as 1878. The rate was one halfpenny in the pound on the capital value of all real estate, less the assessed value of the improvements. This law, however, proved to be very unpopular, as a hardship upon the farmers. Accordingly in the following year, 1879, the land tax was abolished and was replaced by a general property tax of one penny in the pound

[1] The issues in the electoral campaign of 1895 did not turn on the budget. Both parties were committed to the income tax, to the "death duties," to the principle of graduation, and to the reform of local taxation.

[2] The present chapter deals only with New Zealand. For the movement in Australia proper, see the following chapter.

[3] An act to regulate the assessment of land and income for the purposes of taxation. Sept. 8, 1891.

on all property, real and personal, over £500. Although this tax worked fairly well at first, it soon followed the usual history of the general property tax; and as personal property slipped out of the assessment lists, the burden came to be felt severely by the farmers. Accordingly, after a long agitation, the general property tax was in turn abolished. Although the new law of 1891 imposed a tax on land, the government was careful not to repeat the mistake of 1879, and therefore coupled with the land tax a tax on incomes from all other sources than land. The income tax and the land tax were really distinct measures, although they were generally coupled together, and were dealt with in various sections of the same act; but, although distinct, they were complementary. In framing a scheme of income taxation, three possible methods may be followed. We may attempt to reach the income as a whole, from all sources, and have a general income tax; or we may separate the sources of income and levy a distinct tax on each, as on land incomes, on business incomes, on professional incomes, and so forth; or, thirdly, since the yield of land everywhere forms so important a share of national income, we may split the tax into only two parts, one of which endeavors to hit the income from land, while the second is intended to reach all the other forms of income. Since the selling value of real estate, in modern communities where land is continually bought and sold, is approximately the capitalized value of the income, it makes little difference whether we assess the land on its income value or on its property value. New Zealand, following the example of some of the Swiss commonwealths, adopted this third method; that is, New Zealand endeavored substantially to reach the entire income by levying a land tax on the capitalized income from land, and by assessing the income from all other sources through the so-called income tax.[1]

The income tax is levied on corporations (or "companies") and individuals. The former are taxed on their net income, but the security holders are then exempt. In most cases profits

[1] The colony of Victoria shortly thereafter followed the other principle in levying a general income tax. By "the Act to impose a Tax on Incomes," Jan. 29, 1895, incomes below £200 were free; on incomes from personal exertion, the rate was fourpence per pound up to £1,200, sixpence per pound up to £2,200, and eightpence per pound on larger amounts; on incomes from the produce of property within Victoria the rates were exactly double. These rates were subsequently changed in 1903–5, although the principle was retained.

from mortgages are not included in income, because mortgages are treated as interests in land and are accordingly subject to the land tax.[1]

Individuals are assessed on their income derived either from business, or from employments or emoluments. This last category is very broad, including profits from "the exercise of any profession, employment, or vocation of any kind, or from any salary, wages, allowances, pension, stipend, or charge or annuity of any kind not charged on land." In order to prevent double taxation, however, it is provided that when any business or other income is derived from land, a sum equal to five per cent on the value of the land assessment may be deducted from the taxable income. Not only private corporations, but all local authorities and individual employers, are required to furnish full lists and salaries of persons employed by them. The income tax is payable only on the excess over £300, and certain minor deductions are allowed. The rate is fixed by periodical acts, according to the needs of the colony; in 1893 [2] it was fixed at a shilling in the pound, or five per cent. In the case of private individuals, incomes from £300 to £1,000 are charged two and one-half per cent, while the full rate is assessed only on the excess above £1,000; in the case of corporations the rate is uniformly five per cent. The £300 exemption is accorded only to persons domiciled or permanently resident in the colony.

The second half of the general scheme of taxation is the land tax. An important and valuable feature of the law is the treatment of mortgages, which are regarded for the purposes of taxation as real estate. The landowner is taxed on the value of the land, less the amount of the mortgage which is required to be registered; and the mortgagee is taxed on the value of the mortgage. Land under £500 in value is exempt, and accordingly the exemption is accorded to mortgages of the same amount. The mortgage, however, is assessed to the mortgagee at its actual value—a provision of importance when the value of the security does not equal the mortgage debt. The result is that the government gets its tax on the whole value of the land, that there is no double taxation on the mortgagor, and that the mortgagee or

[1] But under a later amendment, banking, loan, building and investment companies must include in their return of income the income from mortgages, and are liable for income tax, not for land tax. *Cf.* the Land and Income Assessment Act Amendment Act, Oct. 2, 1893.

[2] An Act to impose a Land Tax and an Income Tax, Oct. 6, 1893.

owner of personal property loaned on the land must bear his due share of taxation. The law does not attempt to consider the ultimate incidence of the tax. The provisions apply, as pointed out above, to corporations as well as to individuals, with the exception of banking and loan associations.

An interesting section is that dealing with the tax on improvements, which are defined to include "houses and buildings, fencing, planting, draining of land, clearing from timber, scrub, or fern, laying down in grass or pasture, and any other improvements whatsoever, the benefit of which is unexhausted at the time of valuation." In the original law such improvements were exempted up to the value of £3,000; but under the amendment of 1893 the exemption was extended to the value of all improvements, of whatever amount, the tax now being levied only on the bare value of the land. The significance of this change will be estimated in a moment.

The most important feature of the new legislation is the adoption of the progressive system. The Australasian colonies had been growing restless under the gradual aggregation of land into the hands of a few proprietors, and some of them have attempted to check the process by a system of progressive inheritance taxes, like that introduced into England. In New Zealand, however, the situation was especially acute. Two-thirds of one per cent of the landowners held forty per cent of the land values; and one-eightieth of the rural landholders owned two-fifths of all the land values. It was, therefore, decided to impose a progressive tax on living landholders, instead of on the estates of deceased property owners. Accordingly in 1891, a graduated tax was imposed in addition to the ordinary land tax. The latter was fixed at one penny in the pound, while the additional graduated tax began at an eighth of a penny and rose to a penny and six-eighths. In 1893, however, the rate of progression was still further increased. in order to obviate any diminution of revenue which might result from the complete exemption of all improvements. Accordingly, the additional tax was made to vary from one-eighth of a penny to twopence in the pound, with the result that the largest estates now paid a total land tax of threepence in the pound.[1] But the tax was even larger than would

[1] The scale as amended in 1893 was as follows:—

When the value is	£5,000 and less than	£10,000	one-eighth of a penny.
" " " "	10,000 " " "	15,000	two-eighths of a penny.
" " " "	15,000 " " "	20,000	three-eighths of a penny.
" " " "	20,000 " " "	25,000	four-eighths of a penny.
" " " "	25,000 " " "	30,000	five-eighths of a penny.

appear from these figures, because of the provision that in the case of the graduated tax the value of the mortgage could not be deducted from the value of the land. Deduction was permitted only in the ordinary land tax, or in the case of estates under £5,000 in value. On the other hand, the mortgage itself was never liable to the graduated tax. We thus have for the first time in any English-speaking country a graduated scale in a direct property tax. England and her colonies led the way not only in progressive inheritance taxes, but also in progressive property taxes. The drift is unmistakable.

It might be thought by some that the adoption of this progressive land tax implied a process of confiscation by the government. In order to preclude all possibility of such an interpretation, the New Zealand law had inserted an ingenious clause, which reminds us in some respects of the ἀντίδοσις in ancient Athens. If a man thought that he had been assessed too high for the extraordinary property tax or liturgy, as compared with a neighbor who had been passed over, he could call upon the latter to assume the tax; and in case of the neighbor's refusal, he could demand an "exchange of property," out of the proceeds of which the tax was defrayed. In New Zealand the government takes the place of the third party. In other words, if a taxpayer thinks that he is assessed too high, he can call upon the government to purchase his land at his own original valuation; he has the alternative to pay the tax at the official valuation or to sell the land at his own valuation. It is readily seen that in this way no property can be confiscated. On the other hand, the government in its turn may purchase the land at the assessed valuation plus ten per cent additional, in case the owner will not consent to the official valuation. As a matter of fact, advantage was soon taken of the provision in the case of the so-called Cheviot estate, of over 84,000 acres. which was returned by the owners in 1892 at £260,220, but which was assessed by the government at £304,826. The government refused to reduce the assessment, and the owners called on the government to pur-

When the value is	£30,000 and less than	£40,000	six-eighths of a penny.
" " " "	40,000 " " "	50,000	seven-eighths of a penny.
" " " "	50,000 " " "	70,000	one penny.
" " " "	70,000 " " "	90,000	one penny and one-eighth.
" " " "	90,000 " " "	110,000	one penny and two-eighths.
" " " "	110,000 " " "	130,000	one penny and three-eighths.
" " " "	130,000 " " "	150,000	one penny and four-eighths.
" " " "	150,000 " " "	170,000	one penny and five-eighths.
" " " "	170,000 " " "	190,000	one penny and six-eighths.
" " " "	190,000 " " "	210,000	one penny and seven-eighths.
" " " "	210,000 or exceeds that sum		two pence.

chase the property. This was done in 1893, and the government thereupon proceeded to carve it up into small plots and gradually to dispose of it.[1]

It remains to estimate the meaning of the exemption of improvements. The American newspapers were filled with accounts of the introduction of the single tax in New Zealand, and the enthusiastic followers of Henry George were jubilant. But when the law and the official reports are carefully scrutinized, the enthusiasm seems to be somewhat misplaced.

There can indeed be little doubt that Mr. George's views exerted some influence in the enactment of the law. It must, however, be remembered in the first place that New Zealand's earlier land-value tax had been imposed in 1878, before Mr. George's first pamphlet had even seen the light; and in the second place that the provisions of the law may be explained without any reference to those particular views. In young and rapidly growing communities, concessions are frequently made which would be out of place amid more settled industrial conditions. Thus the social effects of taxation or of the remission of taxation are clearly recognized in the laws of some American states, which exempt from assessment for a limited period new industrial enterprises, timber lands and various kinds of improvements on land. There is in such cases no implication that the owners of these establishments or forests or improvements are free from fiscal obligations toward the state; for to the extent that they have property or income, they also are ultimately liable. But it is deemed so desirable to foster these new forms of enterprise that the community as a whole is willing to bear the additional temporary burden in order to realize more permanent benefits. The government of New Zealand stated at the time the bill was introduced that their object was to induce large landowners to improve their lands, and thus to bring about an increased national production.[2] Looked at from this point of view, there is much to be said for the provision, which, however, does not mean that the small farmer was as greatly bene-

[1] *Financial Statement in Committee of Supply* by the Colonial Treasurer, 1893, p. 19, Wellington, 1893.

[2] "It will be admitted that the repeal of the tax on improvements should have the effect of encouraging the owners of large properties to expend money in improving their land, and thereby add to its productiveness. This would be a direct advantage to the colony as a whole, both by causing an expenditure on labor, and by adding to the products."—*Financial Statement in Committee of Supply*, 1893, p. 18.

fited as some might imagine. The official assessments show that, whereas in the country districts or counties the unimproved value of the lands exceeded the value of the improvements, the reverse was true in the towns or boroughs. The figures for 1893 are as follows: [1]—

	Actual Value	Value of Improvements	Unimproved Value
Counties	£85,818,167	£27,922,735	£57,880,233
Boroughs	36,406,862	18,442,562	17,907,662
Totals . .	£122,225,029	£46,365,297	£75,787,895

That is to say, in the boroughs the improvements were worth actually more than the bare land, while in the country districts the land was worth more than twice as much as the improvements.

The claim of the single taxers that the farmer will benefit at the expense of the city lot-owner is therefore questionable in New Zealand as indeed it is in other parts of the world.[2] The figures show that the object of the law was not so much to discourage the urban landowner as to reach the large rural proprietors. As between the small farmer and the city landowner, the law was distinctly unfavorable to the former, for the exemption of improvements removed over one-half of the townsman's tax, but less than one-third of the farmer's tax; that is, it relatively increased the tax of the farmer. Were the land to be owned by small farmers, the system would have been unpopular; but it is precisely because the land is not owned by small farmers that the law was enacted. The exemption of improvements was a corollary of the graduated tax on land. When any part of the improvements was exempt, the tax was graduated; and when the exemption was made complete, the scale of graduation was increased.

The claim that the new law meant the introduction of the single tax is still further weakened by the fact that it went hand in hand with the extension of the income tax on other sources than on land. Finally, the contention that there now was any single tax at all in New Zealand is rendered absurd by the fact that in 1894 the revenues from the land amounted to £285,000 out of a total revenue of over four and a quarter millions, the larger part of which was derived from indirect taxes. In other

[1] *New Zealand Official Year Book, 1893,* by E. J. von Dadelszen, p. 429.
[2] *Supra,* pp. 86–91.

words, the "single" tax yielded about six and a half per cent of the colonial revenues, and of course, when we take into account the local revenues, composed chiefly of the general property tax, a much smaller proportion of the total income. The reader is thus in a position to judge how much foundation there is for the statement that the prosperity of New Zealand was to be ascribed to the "single" tax. The real intent of the new legislation was to make the large property owners pay more than they had hitherto been paying, and to subject to taxation other classes that had hitherto been exempt.[1] It was thus an attempt to realize the principle of faculty in taxation.

III. *Holland*

In the review of the tax reforms in England and New Zealand we have seen that the changes were largely the outgrowth of popular agitation; in the states now to be discussed the reforms were more directly the result of scientific discussion. This is especially true of the Netherlands, where the tax laws in question were due to N. G. Pierson, the author of the ablest Dutch treatise on economics and finance. Mr. Pierson was at one time a university professor, and was for many years the president of the Bank of the Netherlands. For several decades he had been devoting himself to the consideration of fiscal problems, and when in 1891 he was made Minister of Finance, he immediately set about the task of bringing the tax system more into accord with the demands of modern theory. In his budget for 1892 he sounded the keynote of the new program—a more equitable distribution of the burden of taxation—claiming that the poorer classes were taxed too much, and the wealthy too little. The problem was how to restore an equilibrium.

The Dutch revenue system was composed in large part of indirect taxes. Import duties, it is true, were very light, but the internal revenue or excise taxes were still burdensome. The direct taxes comprised, as in France and some other countries, a land tax, a business tax, and a "personal tax" calculated according to house rent. The business tax had grown to be very unequal, being based on rough outward signs; and the personal tax, which took the same proportion from large and small

[1] "The end sought to be attained by the whole scheme is to compel contribution to the requirements of the state according to the ability of those who are called upon to contribute thereto." "Statement by the Commissioner of Taxes in New Zealand," *N. Z. Official Year Book for 1894*, p. 44.

rentals, proved to be a serious drain on the poorer classes. Whole sections of the population, moreover, were virtually exempt. Mr. Pierson therefore proposed a four-fold reform:—

(1) The abolition or decrease of the more vexatious excise duties; (2) the enlargement of the business tax into a general income tax; (3) the reconstruction of the personal tax through the introduction of a progressive scale and through other changes; (4) a reform of local taxation so that the local and general taxes together might form a harmonious whole. Of these reforms only the first two were accomplished, when the ministry was overthrown on an entirely different point. Yet even these partial reforms represent a distinct step in advance and deserve our attention.[1]

The first step was the reduction in the excise duties. In 1892 the excise on soap was abolished, and that on salt was reduced from nine to three florins per hundred kilogrammes. The vexatious registration duty on the transfer of land was lowered from 6.27 to 2.15 per cent, or in the case of a second transfer within the same year from 1.09 to 0.40 per cent. With the exception of a minor tax on meat, there were then left only the duties on spirits and on sugar, which were retained as in other countries as essential features of the tax system. This reform in itself proved to be a distinct relief to the poorer classes.

Of more importance were the changes made in the direct taxes. The business tax, akin to the French *patentes*, had become in many ways inadequate and unjust, and was now to be replaced by a tax on the actual, rather than on the assumed, income and was furthermore to be extended so as to reach income from other sources than from business. Pierson deemed it wise to separate this tax into two parts, one of which should apply to the income from property alone, while the other should include all other incomes. In the first case, however, it was thought best to make the tax in large part one on the property itself, rather than on the income from property. The earlier law thus provided for what is termed the property tax.[2]

The question that immediately presents itself is: Why should

[1] The best account of the changes, of the discussion in parliament and of the previous attempts at tax reform, will be found in an elaborate article by G. M. Boissevain, "Die neueste Steuerreform in den Niederlanden," in *Finanz-Archiv*, vol. xi., pp. 419–746. This also contains the text of the laws themselves.

[2] Act of Sept. 27, 1892.

there be a separate property tax? The answer is: largely for administrative purposes. The administration of the tax would thereby be put into the hands of officials already familiar with the land and inheritance taxes, while the income tax would naturally fall to the officials acquainted with the business tax; secondly, the local authorities might desire to add a percentage to the property tax rather than to the income tax; thirdly, it would be the most convenient method of providing for a different or higher taxation of income derived from property than of income derived from labor. In addition to these points the rather doubtful argument was advanced that the same amount of capital affords different rates of income according to the varying security of the principal, and that the poor man who cannot afford to make much of a choice generally prefers securities with higher rates of interest; to tax income instead of capital would thus be to favor the rich man. Finally, in answer to the objection that a non-dividend-yielding security would also be taxed, it was urged that this could not be avoided even under an income tax; for if the capital value of a security should fall in any one year more than the amount of the interest or of the ordinary dividend, the income tax would be paid not from income, but from capital.

Dubious as some of these reasons were, they found favor with parliament. Even in the property tax, however, the principle of income was not wholly abandoned; for in the case of real estate the capital value was fixed at twenty times the annual revenue, unless the owner elects to be assessed according to selling value. It may be said in passing that the property tax applies only to individuals, not to corporations; and that furniture, objects of art, scientific apparatus, life insurance policies and a few other categories [1] are not yet included in taxable property.

A point of considerable importance is that the old land tax is levied in addition to the property tax. The landowners had for many years blocked the way to any change in the system by asserting that to tax their land by the land tax and again by the property tax would involve gross double taxation. Mr. Pierson, however, had long ago espoused the capitalization theory of the land tax, and had maintained that an exclusive tax on land becomes a kind of rent-charge, depressing the sell-

[1] Such as articles of food; the right to pensions or annuities; property of which the usufruct is enjoyed by some one else; debts, wages and other income which is yet due.

ing value of the land by a sum equal to the capitalization of the tax. The new purchaser, he argued, makes an allowance for the tax in the purchase price, and buys to that extent an exemption from future taxation. Since, therefore, all other owners of property were to be taxed for the first time, it would be unjust to exempt the landowners from the property tax. The land tax is a rent-charge; the property tax is a real tax. The situation was deemed to be the same as in England, where the land tax exists side by side with the income tax on land.

Were this chapter anything more than a bare summary of recent legislation, it might be shown that there was a partial fallacy in Mr. Pierson's reasoning. For the theory of amortization, as it is called, holds good only on the assumption that the land tax is exclusive; while, as a matter of fact, even under the old Dutch system, there was also a tax on business or business property. Be that as it may, Mr. Pierson's argument prevailed; but several concessions were made to the landed interest. The rate of the land tax was reduced from seven to six per cent; the transfer duties on land were abolished; the official assessment of land for the property tax was purposely kept somewhat below the actual value; and land used for agriculture, by a legal fiction to be stated in a moment, was exempted from the income tax. In these several ways it was sought to remove the imputation of double taxation. It may be questioned, however, whether this object was entirely attained.

The fundamental feature of the new system is the coordination of the property tax with a complementary income tax, for the purpose of reaching through a combination of the rates the entire taxable faculty of the individual. The official name of the income tax is "tax on income from occupations and other incomes,"[1] although it is generally called the business tax. The tax is levied on all "gains and wages," which are defined to include "the amount of all net revenues from business, trade, manual labor, occupation or enterprise from temporary work or activity of any kind, from contractual or non-contractual profits, whether in cash or in securities." The law applies to corporations as well as to individuals, while the property tax applies only to individuals; but if the corporation pays the income tax, individual security holders are exempted. In order to obviate the double taxation which would result from taxing business capital through the property tax and business

[1] Belasting op bedrijfs- en andere inkomsten. Act of Oct. 2, 1893.

profits through the income tax, recourse is had to an expedient so familiar in Switzerland and also practised in Massachusetts. The property tax is presumed to reach an income of four per cent; hence the income tax is payable in almost all cases only on the surplus profits above four per cent. In this way the property and the income taxes together are deemed to reach the whole income.[1] In the case of capital invested in land, the income is declared to be legally equivalent to four per cent. Agricultural capital is hence exempt from the income tax, as it had previously been free from the business tax, although the land is liable to both the property and the land tax.

In respect of the rate of taxation the new Dutch laws recognize the principle of differentiation as well as of progression. To differentiate the rate by taxing incomes from property more heavily than incomes from labor was, as we know, one of the avowed reasons for the enactment of the two separate laws, and did not meet with much opposition. But when the project of graduating the tax was introduced, the discussion, as in all such cases, grouped itself about two main points. On the one hand the partisans of a strict proportional rate maintained that progression means socialism and confiscation; on the other hand the extremists declared their belief in the socio-political theory of taxation, according to which progressive taxation should be utilized as an engine to remove inequalities in fortune. Pierson took the middle ground, declaring his opposition to both these theories and maintaining that a moderate progression was a logical conclusion from the theory of faculty in taxation. "Progressive taxation," as he put it, "must never be a principle (as the socialists would have it), but only the application of a principle."

The practical arrangement was as follows: Property under 13,000 florins is entirely exempt; from 13 to 14,000 the tax is fl. 2; from 14 to 15,000 it is fl. 4. If the property exceeds fl. 15,000 but is less than fl. 200,000, the tax is 1.25 per mill for the surplus over fl. 10,000. Property of fl. 200,000 would therefore be taxed fl. 237½. For every fl. 1,000 above fl. 200,000 there is an additional tax of fl. 2. In other words, there is a deduction in all cases for a certain part of the property (fl. 10,000); there is a complete exemption for a minimum of subsistence (fl. 13,000), and an abatement for a somewhat larger

[1] For a fuller discussion of this arrangement from the standpoint of theory, see *supra*, p. 102 and pp. 274-276.

amount (fl. 15,000); and finally there is a slightly progressive rate. For if income on property is reckoned as four per cent, the property tax of 1.25 per mill (on sums below fl. 200,000) equals an income tax of three and one-eighth per cent; while a property tax of two per mill (on sums above fl. 200,000) equals an income tax of five per cent. Owing to the deduction of fl. 10,000 as well as to the complete exemption of fl. 13,000 and the abatements for fl. 13,000 and fl. 14,000, the property tax computed as an income tax would vary from zero to almost five per cent. This will be seen from the following table:—

Property. fl.	Tax. fl.	Amount per Mill.	Percentage of Income.
12,000	0	0	0
13,000	2	0.15	0.37
14,000	4	0.29	0.72
15,000	6.25	0.41	1.02
20,000	12.50	0.62	1.55
25,000	18.75	0.75	1.87
50,000	50.00	1.00	2.50
100,000	112.50	1.12	2.80
150,000	175.00	1.17	2.92
200,000	237.50	1.19	2.97
210,000	257.50	1.23	3.07
220,000	277.50	1.26	3.15
250,000	337.50	1.35	3.37
500,000	837.50	1.67	4.19
1,000,000	1,837.50	1.84	4.59
3,000,000	5,837.50	1.95	4.86
5,000,000	9,837.50	1.97	4.92
10,000,000	19,837.50	1.98	4.96
20,000,000	39,837.50	1.99	4.98

In the income tax it was proposed to observe the same principle of graduation, but the rate was to be less. Since fl. 200,000 is equivalent to fl. 8,000 income, the original plan was to tax incomes from labor above a certain minimum two per cent up to fl. 8,000, and three and one-fifth per cent above that, instead of the three and one-eighth per cent and five per cent rates of the property tax. That is, incomes from labor were to be taxed three-eighths less than incomes from property. It was decided, however, to make the minimum of subsistence higher in the income tax than in the property tax, partly because of the existence of indirect taxes, partly for other reasons. The consequence was the necessity of two schedules in the income tax, one for incomes from labor alone, and one for

taxpayers already subjected to the property tax. In the former case the tax is levied only on the surplus above fl. 650; but as the property tax is levied only on the surplus above fl. 10,000 (which corresponds to an income of fl. 400), the tax on incomes from property is levied on the surplus above fl. 250 (or the difference between fl. 650 and fl. 400). The higher rate, therefore, begins in this case not with fl. 8,000 (as in the case of labor incomes), but with fl. 8,200. This would result in the following schedules, which, although seemingly complicated, are the results of simple computations:—

Schedule A.
Incomes from Labor.

Income.	Tax (in florins).
650 to 700	1
700 " 750	2
750 " 800	2.75
800 " 850	3.50
850 " 900	4.25
900 " 950	5
950 " 1000	5.75
1000 " 1050	6.50
1050 " 1100	7.25
1100 " 1150	8
1150 " 1200	8.75
1200 " 1250	9.50
1250 " 1300	10.25
1300 " 1350	11
1350 " 1400	11.75
1400 " 1450	12.50
1450 " 1500	13.25
1500 " 1600	14
1600 " 8200	14+

2 per cent on surplus over fl. 1500.

Over fl. 8200, fl. 148 +3.20 per cent on surplus over fl. 8200.

Schedule B (for those liable also to the Property Tax).

When Property amounts to fl. 13,000 or fl. 14,000.

Income.	Tax (in florins).
250 to 300	2
300 " 350	2.75
350 " 400	3.50
400 " 450	4.25
450 " 500	5
500 " 550	5.75
550 " 600	6.50
600 " 650	7.25
650 " 700	8
700 " 750	8.75
750 " 800	9.50
800 " 850	10.25
850 " 900	11
900 " 950	11.75
950 " 1000	12.50
1000 " 1050	13.25
1050 " 1150	14
Over 1050	14+

2 florins for every hundred florins on surplus over fl. 1050.

But if the income, together with 4 per cent on the taxable property, exceeds fl. 8150, a tax of 1.20 per cent is payable on the excess.

When Property varies between fl. 15,000 and fl. 200,000.

Income.	Tax (in florins).
250 to 300	1.25
300 " 350	2
350 " 400	2.75
400 " 450	3.75
450 " 500	4.25
500 " 550	5
550 " 600	5.75
600 " 650	6.50
650 " 700	7.25
700 " 750	8
750 " 800	8.75
800 " 850	9.50
850 " 900	10.25
900 " 950	11
950 " 1000	11.75
1000 " 1050	12.50
1050 " 1100	13.25
1100 " 1200	14
Over 1100	14+

2 florins for every hundred florins on surplus over fl. 1100.

But if the income, together with 4 per cent on the taxable property, exceeds fl. 8200, a tax of 1.20 per cent is payable on the excess.

When property exceeds fl. 200,000, the tax is 3.20 on every hundred florins income over fl. 200.

It may be said, in passing, that there are two additional schedules in the income tax; corporations being taxed in all cases two and one-half per cent, and foreign travelling salesmen paying a fixed tax of fl. 15. Of the administrative features of the laws the chief point is that the returns both of property and of income rest on the principle of self-assessment, supplemented by careful official scrutiny.

After the passage of these two acts Pierson prepared to undertake the reform of the personal tax and of the local revenue system. He had gone so far as to contemplate the introduction of the progressive scale into the tax on house rentals; but before the bill could be discussed and before his wider plans for other changes were completed, he was compelled to resign for reasons entirely disconnected with these financial problems.

The reform of the Dutch tax system was thus only partial; but enough was accomplished to entitle Pierson to a high place in the ranks of fiscal reformers. The exaggerated burdens on the lower classes were lessened, the tax on incomes was generalized and equalized, and the principles of progression and of differentiation were introduced; in short, a notable step was taken toward the realization of the doctrine of faculty. Although open to criticism in some of its details, the change represents undeniable progress.

IV. *Prussia*

While England, Holland and New Zealand were occupied chiefly with the reform of general state taxation, Prussia was fortunate enough to take one step further and to address herself to the solution of a problem which the reformers in other countries declare to be their next point of attack. The reform of local taxation, and the establishment of proper relations between the general and the local revenue systems constitute problems which to-day confront all countries; for no really harmonious system of taxation can ever be attained until the claims of conflicting or overlapping jurisdictions are satisfactorily adjusted. In federal states like Germany, Switzerland and the United States the matter is complicated by the demands of the central government; but in all countries the fiscal relations between the state and the local spheres of government are more or less confused and unsatisfactory. The immense increase in local needs has everywhere so pushed this problem

into the foreground that the solution inaugurated in Prussia is a matter of far more than mere local importance.

In order to understand the situation, it is necessary to dwell for a moment on the Prussian tax system. In Prussia, as well as in the other German states and in most of the remaining countries of the continent, the state system had been based on the principle of taxing product. The old general property tax long since disappeared and was replaced by a system which attempted to reach the constituent elements of produce. Instead of taxing a man personally on his property, the plan was to tax the various sources of revenue themselves. The thing, and not the person, was primarily responsible; and therefore the new taxes received the name of real taxes, as compared with the former personal taxes.[1] These taxes on product (*Ertragsteuern*) as they are called in Prussia, or real taxes (*impôts réels*) as they are called in France, everywhere included taxes on the product of land, of buildings and of business. In addition to these, one or two other taxes were sometimes utilized, to round out the system. What was omitted in the three taxes above was the product of money lent at interest and the produce of labor. Some of the German states therefore, desiring to be logical at all costs, added a tax on interest (*Kapitalrentensteuer*) and a tax on wages (*Lohn- und Besoldungsteuer*). In most cases, however, the wages tax was omitted because the laborer already bore more than his share, and the tax on interest was replaced by a more general tax which endeavored in some way to reach the individual condition of the taxpayer. Thus in France shortly after the Revolution the "personal and movables" tax was introduced, which tried to reach individual ability through expenditures;[2] while in Prussia the three taxes mentioned above were supplemented by a class tax, which was to reach the taxpayer in some rough proportion to his revenue.

In the course of time, however, it came to be recognized that product was for many reasons too rough a test of faculty; and the tendency, recent evidence of which has been seen above,

[1] This nomenclature must, of course, not be confused with that sometimes employed in America, where real taxes mean taxes on realty, and personal taxes denote taxes on personalty.

[2] In France, it is true, there was an additional tax, "the door and window tax." But all French writers confess that it is indefensible and it, like the other "real taxes," was abolished in 1917 when the income tax was introduced.

was to replace product by income. Thus, the class tax in Prussia was somewhat modified as early as 1821 in the direction of an income tax, until after successive changes in 1851 and 1873 it became a complete general income tax in 1891. The land, house and business taxes were nevertheless retained. This mixture of taxes on product and on income was recognized as illogical, but was defended on the ground that the government could not yet dispense with the former. At the same time the business tax was radically reformed, so as to afford a far more accurate criterion of real business income. Finally, the same year, 1891, saw the recasting of the old probate duties into an inheritance tax, which especially with the amendments of 1895 became a modern collateral inheritance tax with rates graduated from one to eight per cent according to relationship. The reform of the taxes on income, business and inheritances, while exceedingly important, will be passed over here, partly because the laws were enacted several years earlier and have been treated as separate measures elsewhere,[1] and partly because the principles involved are about the same as those alluded to in the reform of Dutch taxation. Above all, the real significance of the recent Prussian legislation lies in a different domain.

The Prussian legislator, in desiring to reform the whole tax system, was confronted by several tasks. In the first place, in order to realize the principle of the taxation of persons rather than of product, it was necessary to supplement the income tax by some other, so that their joint yield would render it possible to dispense with the taxes on product; secondly, it was necessary, as in Holland and elsewhere, to provide for a differentiation as well as for a progression of taxation; thirdly, since local needs differ from general needs, a distinction had to be drawn between the sources of local and general revenue. Separate taxes thus had to be assigned to each sphere of government activity.

Let us see how these several tasks were accomplished. Just as the English reforms were largely the work of Harcourt,

[1] For the income tax *cf.* Seligman, *The Income Tax*, 1911, pp. 250–258. For the business tax, *cf.* J. A. Hill, "The Prussian Business Tax," *Quarterly Journal of Economics*, viii., p. 77. The most elaborate treatment of the subject is to be found in two articles by Professor A. Wagner, "Die Reform der direkten Staatsbesteuerung in Preussen im Jahre 1891," *Finanz-Archiv*, viii., pp. 551–810, and xi., pp. 1–76. *Cf.* the articles by Jastrow, "Studien zur preussischen Einkommensteuer," in *Jahrbücher für Nationalökonomie und Statistik*, lviii., pp. 634, 839, and lix., p. 75.

and as the Dutch reforms were due to Pierson, so in Prussia the chief credit must be given to the finance minister, Dr. Miquel, although he was here simply walking in the path cleared for him by the foremost economists.[1]

When the income-tax law of 1891 was discussed, the hope was expressed that its yield might be sufficient to enable the state to dispense with the taxes on product; for notwithstanding the labored arguments of some writers, the simultaneous existence of income and of produce taxes was recognized as illogical. Even though the principle of progression was applied to the income tax, it was thought that the yield would fall far short of the desired amount. Since an increase of the rate above the four per cent fixed in the law as a maximum was impossible, an earnest effort was made to expand the existing collateral inheritance tax into a direct inheritance tax. This plan, however, came to naught; and nothing remained, therefore, but to continue the old taxes on product.

The agitation, nevertheless, went on and was helped along by what was conceded to be a defect in the income tax. Although the principle of progression had been introduced, no provision had been made for a differentiation of the rate. Income from labor was taxed at the same rate as income from property. Dr. Miquel therefore proposed to introduce a supplementary property tax, hoping in this way to achieve both of the desired results. Since this property tax, like all nominal property taxes, would really be paid out of the income of the property, it was thought that it would act as an additional tax on income in so far as the income was derived from property. Incomes from labor would pay only the income tax; incomes from property would pay both income tax and property tax. Thus a practical

[1] The leading German articles on the topics are as follows: J. Jastrow, "Die Vermögensteuer und ihre Einfügung in das preussische Steuersystem," *Jahrbücher für Nationalökonomie und Statistik*, lix., p. 161; R. Friedberg, "Zur Reform der Gemeindebesteuerung in Preussen," *ibid.*, pp. 321-341; F. Adickes, "Ueber die weitere Entwickelung des Gemeinde-Steuerwesens auf Grund des preussischen Kommunalabgabengesetzes vom 14 Juli, 1893," in *Zeitschrift für die gesammte Staatswissenschaft*, li., pp. 410-452, 583-658. The best treatment of the whole topic, including a history of the earlier system, a description of the government bills, and the discussions in Parliament, as well as the text of the law itself with commentaries, is to be found in F. Adickes, *Das Kommunalabgabengesetz vom 14 Juli 1893, für den praktischen Gebrauch mit einer geschichtlichen Einleitung und Erläuterungen versehen*, Berlin, 1894, 8vo, 396 pp.

differentiation would be introduced. This supplementary tax, moreover, would be levied on the property owner and would be a substantial addition to the personal taxes, rendering it possible for the state to dispense with the taxes on product.

This reasoning prevailed, and resulted in the enactment of the law of 1893, which was, however, not to go into force until April 1, 1895.[1] The law provided for a "supplementary tax" of five-tenths, or one-half of one, per mill on all property. Exemption was granted to all property of less than 6,000 marks; to all persons whose income does not exceed 900 marks, provided their property does not exceed 20,000 marks; and to women wage earners and minor orphans whose income does not exceed 1,200 marks, and whose property does not exceed 20,000 marks.

What is more important is the change that was now made possible in the local revenue system, and in its relation to the state system.

The German local revenue system was exceedingly unsatisfactory. In most of the towns indirect taxes on consumption played a considerable rôle; in some places indirect taxes on transfers yielded a substantial sum. But so far as direct taxes are concerned, we find everywhere that the towns simply added a percentage to the state taxes, which in most cases would be taxes on product, like the land, house, business, interest, and wages taxes. Where state income taxes existed, a local percentage was also added, so that the amount of income taxes alone paid by a townsman often exceeded eight or ten per cent. Only in four towns, among them Berlin and Frankfort, were there any taxes on rentals. In Prussia the matter was still further complicated by the so-called Lex Huene of 1885, which provided that a certain share of the imperial duties on agricultural products should go to the local divisions instead of to the state.

[1] Ergänzungssteuergesetz von 14 Juli, 1893. The tax is arranged in classes so that the one-half mill rate applies only to the lowest figures in each class.

	Property.		Tax.
Thus	6,000 to 8,000	marks pay	3 marks.
	10,000 to 12,000	" "	5 "
	20,000 to 22,000	" "	10 "
	40,000 to 44,000	" "	20 "
	60,000 to 70,000	" "	30 "

From 70,000 to 200,000 m. the tax increases 5 marks for each 10,000 m. Above 200,000 m. the tax increases 10 marks for each 20,000 m.

The shortcomings of this whole system were so obvious and became so intolerable that Prussia boldly attempted to abolish them at one stroke. The fundamental principles that emerged in the discussion of the subject during the session 1892–93 may be summarized as follows:

The relation of the individual to the local community is somewhat different from his relation to the state at large. The town is to a certain extent an association of business interests. While therefore the obligation of the citizen to contribute to the general burdens should be regulated by the principle of faculty or ability, it is eminently proper that in the case of the local bodies more attention should be paid to the principle of benefits. In the local divisions, an extension should be given to the principle underlying what in the United States are called special assessments and fees. An argument of somewhat the same nature—a discussion of its precise terms would carry us too far astray—led to the demand for the real estate tax as one of the chief sources of local revenue. A tax on real estate is a real tax, a tax on product; it is not a personal tax. Moreover, the real estate tax is an especially good local tax, partly because the benefits of local expenditure accrue primarily to real estate and thus increase the faculty of the owner; partly because making it a local tax would at once remove from the public arena the unseemly disputes about inequality of rates and about equalization, with which the public is scarcely less familiar abroad than in America.

On the other hand, the income tax is unsuitable for a local tax, chiefly because amid modern complications income cannot well be localized. The sphere of local indirect taxes, also, should be restricted, because local taxes on consumption are apt to press with undue severity on the poorer classes. But since other classes, as well as real estate owners, share the duty of contributing to local burdens, the real estate tax should be supplemented by a business tax, in the shape of a real tax, rather than of a personal tax. Thus the conclusion is easily reached: personal taxes in the shape of an income tax and of a supplementary property tax for the state government; real taxes, like the land tax, the house tax and the business taxes for the local bodies. If we join to this a diminution in the local indirect taxes, and an increase of special assessments and of fees, we shall have a system which is logically defensible and practically workable.

In accordance with these ideas were passed the three great laws of July 14, 1893. The first law, which has already been mentioned, provided for the supplementary property tax. The second law [1] abolished as sources of state revenue the real taxes—that is, the land tax, the house tax, the business tax and the old tax on mines, the first three being handed over to the communes or local bodies, and some minor changes being made in the business tax with the same end in view. This law, like the others, was not to go into effect until April 1, 1895; partly in order to leave time for the arrangement of the local system, partly in order to enable the state income tax to be perfected so that its increased yield would more than compensate for the loss of the taxes on product. Finally, the third law [2] regulated the sources of local revenue.

According to this law, the local bodies are not only permitted, but directed, to impose fees and special assessments in cases where the local action results in a special measurable benefit to the individual; and the extent of these charges is definitely regulated. Indirect taxes are not forbidden, but it is provided that no new or increased taxes may be imposed on meat, corn or bread, potatoes or the articles of common consumption. Direct taxes may be imposed on real estate and on business. In special cases a local income tax may be levied as an addition to the state income tax; but a maximum is fixed and permission is given to substitute in its stead taxes on expenditure, which must be so arranged as not to impose on the poor a heavier burden than on the rich. In no case may a local general property tax be imposed, nor may the existing taxes on rentals be increased. The statute does not affect in any way the rights of the local bodies to revenue from industrial enterprises or municipal monopolies, with the one exception that the charges must be sufficient to provide a revenue at least equal to the interest on the outlay and a yearly addition to the sinking fund. The law closes with some minor provisions applicable to county or provincial revenues.

Into the details of these laws it is manifestly impossible to

[1] Gesetz wegen Aufhebung direkter Staatssteuern. This is printed in *Finanz-Archiv*, x., pp. 795–801.

[2] Preussisches Kommunalabgabengesetz. This has been published in *Finanz-Archiv*, x., pp. 318–341. The best edition is the one of Adickes, mentioned above, with commentary and notes.

go. Were there space, it would be fruitful to call attention to some errors in the general theory and to some mistakes in the practical arrangements. Thus the abolition, rather than the improvement, of the rentals tax; the retention of the indirect taxes; the failure to provide for a state inheritance tax; and the inadequate working out of the principles of the corporation tax constitute undeniable blemishes. Above all there was an unfortunate limitation upon the increase of the "real" taxes. It was enacted that for every increase in the rate of the income tax on the part of the localities, there must be at least a similar increase (but at most not more than one-half as much again) in the rate of the real taxes or taxes on product—the taxes on land, buildings and business. If the taxes on product, however, are augmented so as to reach one hundred and fifty per cent of the old rates, further increases are permitted at the rate of two per cent in the income tax for each one per cent in the taxes on product until the latter reach two hundred per cent of the old rate. Exceptions to this rule are permitted only by governmental sanction. The result has been that it has become impossible to raise the real estate tax in the towns without increasing the rate of the income tax to inordinate heights. As a consequence the German cities, which everywhere raise far less revenue from real estate than do the American cities, have sometimes been seriously embarrassed in securing adequate revenue. This is undoubtedly the chief defect in the law.

All these defects, however, sink into insignificance when compared with the one great boon—the acceptance, even in an imperfect way, of the principle of the segregation of source as between local and state revenues. For this all reformers have been contending the world over—in France as in Australia, in Italy as in America. To have successfully accomplished this result and to have brought it into harmony with the doctrine of faculty, is an achievement of sufficient importance to entitle Dr. Miquel to a high place in the ranks of fiscal reformers. The year 1895 will mark an epoch not only in Prussian, but also in international finance.

After this survey it is needless to point out the lessons applicable to the United States. The economic conditions of the civilized world are everywhere fast becoming the same; and upon the changes in economic conditions depend the changes

in financial systems. In old Europe as well as in young Australia the same tendency is unmistakable—the trend to greater justice in taxation. When four widely distant countries reform their systems almost simultaneously, and upon the same general lines, the inference is irresistible that the causes of the movement are of far more than mere local significance. To shut our eyes to this world-wide movement would be supreme folly; to profit by its lessons and to bring our own system into line with the demands of modern science and of modern conditions will be no less wise than it is inevitable.

CHAPTER XVII

RECENT REFORMS IN TAXATION. II. THE REFORMS OF 1909–1910

NOTHING, perhaps, in the history of taxation is more striking than the appearance of successive waves of reform. In the preceding chapter we have studied the movements which culminated at almost the same time in various countries, some of them widely separated from each other. A decade and a half later we find another reform movement which swept over some of the identical countries treated of above, and which, although in some respects proceeding still further on the old lines, yet in other ways struck out in a new direction. The years 1909–1910 are marked by significant changes in the fiscal systems of England, Germany and Australia, and in the same year came the adoption, after several decades' struggle, of the income tax bill by the lower house in France.[1]

I. *Great Britain*

The first place in the history of the reform movement is occupied by Great Britain in the famous Lloyd George budget. This, while making in some respects a new departure in fiscal policy, is nevertheless to be considered in the main as a logical development of a movement initiated some time ago.

The agitation for augmented revenues in Great Britain has been precipitated, as is well known, by the great increase in expenditures, due partly to the prodigious addition to the naval estimates and partly to the new social legislation on old-age pensions and national insurance. Moreover, it is everywhere conceded that England is on the brink of still greater expenditures. For while it may indeed be expected that the mad race for increased naval armaments will before long reach its term, it is not unlikely that the insurance schemes constitute only the

[1] For a study of this subject which is not treated here because the reform had not yet been accomplished, see Seligman, *The Income Tax*, New York, 1911, part I., book 2, chap. 2. The reform was finally accomplished in 1917.

first of a series that will call for increasingly vast outlays. Even if England should adopt the policy of so-called tariff reform, it is improbable that the whole or even the greater part of its increased expenditure will be met by import duties.

Until the repeal of the corn laws, the national revenues of England, like those of almost all other great nations, were derived almost exclusively from indirect taxes. Beginning shortly before the middle of the century, the tendency in England, as elsewhere, has been toward reliance, in an ever greater degree, upon direct taxes. First the income tax was introduced, although timidly and only as a temporary measure. Gradually its administration was improved and its yield increased, until by the end of the seventies it was recognized as a permanent part of the tax system. In the nineties the death duties or inheritance taxes were remodelled, and have since been playing an increasingly important rôle in the budget. And now, finally, the various forms of land revenue were to be added to the list of direct taxes.

It would be a mistake, however, to assume that an overemphasis was put upon direct taxes. On the contrary, a considerable part of the additional revenue in the new budget was to come from indirect taxes. In fact, so far as its fiscal policy is concerned, the Liberal party cannot be said to be opposed to the use of indirect taxes; it is committed rather to the principle that, in order to meet the growing needs of government, recourse must be had to direct as well as to indirect taxes. The English policy is to hold the balance even, not, as is often hastily assumed, to dispense with indirect taxes. Thus, if we take the period from 1895 to 1908—that is, from Harcourt's budget reform up to the year preceding the Lloyd George budget—we find that of the increase in revenues of 44 million pounds 20 million pounds came from indirect taxes and 24 million pounds from direct (as appears from the table on the next page). Moreover, when attention is directed to the reduction of indirect taxes in the budgets of 1906 and 1908, it is sometimes forgotten that equal reductions were made in the direct taxes.[1] From

[1] In an article by J. Watson Grice in the *American Economic Review*, vol. i. (1911), p. 490 *et seq.*, an incorrect impression is left on the reader's mind as to this point. All the remissions of indirect taxes mentioned by Mr. Grice, like those on coal, sugar and tea, were simply remissions of new or additional taxes, imposed during the war period, and were more than counterbalanced by the reduction of the rate of the income tax.

1903, which was the highwater mark of the new budgets, to 1908, the remissions of taxation were nearly the same in each of the two classes.

REVENUE (IN MILLIONS OF POUNDS)

YEAR	INDIRECT TAXES				DIRECT TAXES		
	CUSTOMS	EXCISES	STAMPS	TOTAL	INCOME TAXES	ESTATE DUTIES	TOTAL
1895	20	30	6	56	16	11	27
1903	35	37	8	80	39	18	57
1908	32	36	8	76	32	19	51

It was quite natural, therefore, that when, in 1909, Lloyd George found a little over 14 millions needed to carry out his program, he decided that somewhat more than one-half of the deficit should be raised from indirect taxes: from increased customs duties and excises on liquors and tobacco, together with additional stamp duties, especially on securities, a graduated tax on motor cars and a new tax on petrol. To be precise, the additional indirect taxes were to yield £7,350,000 as against £6,850,000 from additional direct taxes.[1]

[1] The items are as follows:

Liquor licenses . . .	£2,600,000	Income tax	£3,500,000
Tobacco	1,900,000	Estate duties . . .	2,850,000
Spirits	1,600,000	Land value duties . .	500,000
Stamps	650,000		
Petrol	340,000		
Motor-car licenses . .	260,000		
	£7,350,000		£6,850,000

The chief alterations in the indirect taxes were as follows:

Customs duties:

Spirits:	old duty,	11*s*. 4*d*.	per gal.	increased to	18*s*. 1*d*.
	additional duty,	3*s*. 9*d*.	" "	" "	5*s*. 1*d*.
Beer:	old duty,	£1–12*s*.	" bbl.	" "	£1–17*s*. 6*d*.
	additional duty,	1*s*.	" "	" "	1*s*. 2*d*.
Tobacco:	old duty,	3*s*.	" lb.	" "	4*s*. 4*d*
	additional duty,	8*d*.	" "	" "	1*s*.

Incidentally it may be remarked that the law of 1909 repealed the old prohibition against cultivating tobacco in Great Britain (the repeal had already been applied in Ireland in 1908), which had been introduced over two and one-half centuries ago in order to foster the growth of tobacco in the American colonies and to secure the tobacco revenue entirely from customs. Henceforth the tobacco revenue in Great Britain is to come not only from customs duties but also from an internal license of five shillings and the excise.

Bearing in mind, then, the important part which the increase of indirect taxes plays in the new scheme, it remains none the less true that the chief interest of the budget lies in the direct taxes, that is, the income tax, the inheritance tax and the new land taxes.

First, as to the income tax. There are, as is well known, two different kinds of income taxation. The one is the Prussian system of the so-called "lump-sum" income tax, where a man is compelled to make a return of his entire income. The other is the stoppage-at-source system, where the income is classified into a number of categories, and an attempt is made to have the tax paid, not by the person who receives the income, but by the person who pays or advances the income to the recipient. This is the system which the English have adopted, and which they

Excise:

Spirits:	old duty,	11*s*.	per gal.	increased to	14*s*. 9*d*.
Tobacco:	new duty,	3*s*. 6*d*.	per lb.	up to	4*s*. 8*d*.
Motor cars:	new graduated duty,	£2- 2*s*.	for 6½ h. p.	" "	£12 for over 60 h. p.
Petrol:	new duty,	3*d*.	per gal.		

Liquor licenses:

Wholesale dealers in spirits:	£10–10*s*.	increased to	£15–15*s*.
Wholesale dealers in beer:	£ 3– 6*s*.	" "	£10–10*s*.

Retail dealers: duties increased according to a percentage of the annual value of the licensed premises.

Stamp duties:

The duties on conveyances and sales, on leases (except the penny duty) and on marketable securities were doubled. On contracts the old rates of 1*d*. and 1*s*. were increased to 6*d*., rising to £1 on contracts of over £20,000.

The best account of the new excises, stamps and liquor licenses will be found in J. Wylie, *Liquor License Duties, Death Duties, Income Duties, Stamps, Customs and Excises, under Parts II. to VIII. of the Finance (1909–10) Act, with explanatory Notes and References, Rules and Regulations, etc.* (London, 1910).

consider far superior to the Prussian. Under it the total amount of a man's income is not divulged, except in the case of incomes under £700, where certain abatements are permitted. But the English system, largely because of these arrangements, has always involved, at least on all incomes over the normal amount of £700, a simple proportional tax and, until 1907, an undifferentiated tax as well.

The interesting feature of the new provisions is that England is henceforth to enforce both the differentiation and the graduation of the income tax. In other words, not only is a distinction made whereby unearned incomes are taxed at a higher rate than earned incomes,[1] but the beginnings of a real progressive taxation are introduced by the adoption of the so-called super-tax. That is to say, whenever the total income exceeds £5,000, an additional duty of 6*d*. in the pound (over and above the normal rate of 1*s*. 2*d*.) is charged for every pound of the amount by which the total income exceeds £3,000. Moreover, on the smaller incomes, in addition to the abatements that were already in force, it is provided that in the case of all incomes under £500 a reduction of £10 in the tax shall be made for each child. Thus at both ends of the scale modifications of the income tax are provided which look to a greater approximation to the principle of ability to pay.

The importance of the change lies chiefly in the application of the doctrine of progression. In order, however, to make this possible, it has become necessary to abandon, so far as the larger incomes are concerned, the old principle of the stoppage-at-source and to replace it by that of the lump-sum tax. That is to say, the proportional part of the income tax will still be levied as formerly, according to the stoppage-at-source scheme, but the super-tax will have to be assessed according to the lump-sum principle. Although some doubts were expressed as to the administrative practicability of the new plan, it has thus far worked without much friction. The number of super-taxpayers during the first full year of the operation of the law was between ten and eleven thousand, with an aggregate

[1] In 1907, when the general rate of the income tax was 1*s*., earned incomes up to £2,000 were charged only 9*d*. The Finance Act of 1909–10, which fixed the normal rate at 1*s*. 2*d*., left unearned incomes up to £2,000 at 9*d*. and assessed unearned incomes between £2,000 and £3,000 at 1*s*. For full details of what is meant by earned income under these laws, see Seligman, *The Income Tax* 2d. ed. (1914), pp. 202–205.

income of almost 130 million pounds upon which the super-tax was about two and one-half millions.[1] It is worthy of note that the income-tax project adopted by the lower house in France pursues the same double plan.

While the progressive feature was only hesitatingly introduced into the income tax, it has been applied to the inheritance tax since 1894. An interesting feature of the new budget is the great expansion in the scale of graduation. A decided step in this direction had already been taken in 1907, when the rates of the duty on estates over £150,000 were increased, so that estates of a million pounds paid ten instead of seven and one-half per cent, and the maximum rate, on estates over three million pounds, was raised from eight to fifteen per cent.[2] According to the new scheme the estate duty, which begins at the rate of one per cent on estates from £100 to £500, now runs up, in a steep graduation, until it reaches ten per cent on estates between £150,000 to £200,000 and fifteen per cent on estates over £1,000,000.[3] In considering these figures it must be remembered that in addition to the estate duty, which applies to the whole of the estate, there are also the legacy and succession duties, which apply to separate shares of the estate, and which correspond to what are called in America collateral inheritance taxes. These, which are graduated according to relationship, run up to ten per cent. The result is that the

[1] Owing to the contest over the budget the returns for the year 1909-10 did not come in until the following year. For details see the *Fifty-fourth Report of the Commissioners of Inland Revenue* (1911), pp. 99, 100.

[2] For the exact figures of the law of 1907 see Seligman, *Progressive Taxation* (2d ed., 1908), p. 45.

[3] The exact scale is as follows:

On estates	from	£100	to	£500	the rate	is	1	per cent.
"	"	500	to	1,000	"	"	2	"
"	"	1,000	to	5,000	"	"	3	"
"	"	5,000	to	10,000	"	"	4	"
"	"	10,000	to	20,000	"	"	5	"
"	"	20,000	to	40,000	"	"	6	"
"	"	40,000	to	70,000	"	"	7	"
"	"	70,000	to	100,000	"	"	8	"
"	"	100,000	to	150,000	"	"	9	"
"	"	150,000	to	200,000	"	"	10	"
"	"	200,000	to	400,000	"	"	11	"
"	"	400,000	to	600,000	"	"	12	"
"	"	600,000	to	800,000	"	"	13	"
"	"	800,000	to	1,000,000	"	"	14	"
"	over	1,000,000			"	"	15	"

English inheritance tax under its present form is graduated up to the point of twenty-five per cent—figures which are as high as those found in any other part of the world and which, so far as the direct inheritance tax is concerned, exceed anything that is to be found in the United States.

Important as were these changes in the income tax and the death duties, the most significant feature of the budget—and the true cause of the resistance by the House of Lords which led to the epoch-making constitutional changes of the following year—was the introduction of the new land taxes.

II. *The British Land Taxes*

Since the gradual breakdown of the old English land tax and its conversion in 1798 into a redeemable rent charge, land in England had not been subject to any special taxation. The local rates were indeed levied on real estate, and the profits of land were subject to the income tax; but, both in the local rates and in the income tax, land was taxed only when it yielded an actual revenue, and whenever land was not rented or did not yield an actual money income it was not taxed at all. In a country like England, where there are so many large estates utilized for purposes of pleasure or other non-lucrative ends, or held for speculation, this had become a source of great embarrassment. Moreover, even as to the land that is rented, the English system differs from that of the United States in two important respects.

In the first place, in the United States land in the outskirts of the towns is subject to special assessments for local improvements. When the value of the land is enhanced by the opening or grading of streets, a portion of the enhancement of value is taken by the government, which in a sense creates it. In England, with rare exceptions in recent years, this practice is unknown. The British landowner enjoys the increment of value, and the burden of the expenditure is borne by the general ratepayer.

In the second place, land in the United States is taxable at its selling value; and, if the land rises in value as population increases, the landowner must still bear his proportion of the local burdens, even though the land remains vacant or is used for agricultural purposes. While some American towns are indeed in the habit of assessing vacant lots with considerable

tenderness, others pursue a different practice, and in every case it is an easy matter for an aroused public sentiment to make the practice conform to the law, and thus to increase the burdens of the land *pari passu* with the rise of land values. In Great Britain, on the other hand, lands are taxable according to rental value. If they are vacant they are, as we have seen, frequently not taxed at all. If they are rented for agricultural purposes, however, their rental value is manifestly far lower than would be the case if the land were used for buildings. Consequently, even if they are subject to the local rates, they pay a pitifully small amount compared to their real ability to pay; and the growing prosperity of the town results only in benefits to the landowner without subjecting him to any corresponding burdens.

Thus from every point of view the owners of unimproved land in Great Britain constituted a favored class. They were not subject to special assessments, they were not taxed when the land was unrented, and they were undertaxed if the land was rented. In all these respects they were in a position very different from that of the American landowners. The situation in Great Britain was anomalous. The new land taxes were designed to put an end to this situation.

As far back as 1901 a royal commission on local taxation had suggested a local tax on site values; and in 1904 and again in 1905 a bill to this effect had reached a third reading in the House of Commons. In Scotland the movement had been even more decided. As soon as the Liberal party came into power in 1906 a general land-value tax bill applicable to Scotland was passed in second reading, by a large majority. It was then referred to a committee, and on their recommendation it was withdrawn in favor of a local valuation bill. This Scotch land-valuation bill passed the House by a large majority in 1907, but was rejected by the Lords. The same thing happened in 1908. In 1909 both schemes, the English and the Scotch, were finally taken up by the government and considerably extended, not only applying the principle to Great Britain as a whole, but also including several additional kinds of land taxes. With the political struggle which resulted in the complete triumph of the Commons we have not to deal here. The important point was the final acceptance by the country of the principle of the land taxes.

The new land taxes were four in number: the undeveloped-

land duty, the increment-value duty, the reversion duty and the mineral-rights duty.[1]

The undeveloped-land duty is a tax of one halfpenny on the pound on the site value of undeveloped land. Land is declared to be undeveloped if it has not been developed by the erection of dwelling houses or glasshouses or greenhouses or buildings for the purpose of any business, trade or industry other than agriculture, or is not otherwise used *bona fide* for any such business. Although the rate of this tax is very low, it was feared that the scheme might prove to be an entering wedge for future increased taxation; and this apprehension explains the strong opposition which the proposal excited. As the bill went through the House it was considerably altered. As it reached the Lords and was enacted into law, it provided that the tax should not be applied to any land where the site value did not exceed £50 per acre. This at once exempted most of the agricultural land. It was also provided that, in the case of agricultural land where the site value exceeds £50 per acre, the tax should be chargeable only on the amount by which the site value exceeds the value of the land for agricultural purposes. No duty, moreover, is assessed on small holdings, that is, on agricultural land occupied and cultivated by the owner, provided that the total value of all land owned by him does not exceed £500. Ownership under this clause includes leases of fifty years or more. Other exemptions are made in the case of parks, gardens, open spaces to which the public have access as of right or to which the public enjoy reasonable access, land used for games or recreations when such use is not of a purely temporary character, and in general any land where the commissioners think that it is desirable for social purposes to keep the land free from buildings. Furthermore, no duty is charged on the site value of one acre of land, whatever its use, occupied with a dwelling house, nor on the site value of five acres of garden or pleasure grounds occupied with a dwelling house, provided that the site value in question does not exceed twenty times the annual value of the land and house as assessed to the income tax. Again, it is to be noticed that when money has

[1] J. Wylie, *The Duties on Land Values and Mineral Rights under part I of the Finance (1909–10) Act* (London, 1910). *Cf.* also a brief but excellent account in the *Fifty-fourth Report of the Commissioners of Inland Revenue* (1911), p. 149 *et seq.* For a bibliography see Y. Scheftel, *The Taxation of Land Value.* Boston, 1916, pp. 473–478.

been expended within ten [1] years on roads, sewers, *etc.*, with a view to the development of land included in a scheme of land development, the land is to be deemed developed to the extent of one acre for every £100 of such expenditure, and to that extent therefore exempted from duty. Finally, when the increased-value duty mentioned in the next paragraph has been paid on any undeveloped land, the site value is to be reduced by a sum equal to five times the amount of such duty.

In the second place, we come to what is perhaps the most interesting part of the entire scheme, the increment-value duty. This tax is payable when land changes hands under certain conditions; that is, it is levied on the following occasions: (1) the sale of any land or interest therein; (2) its lease for a period of more than fourteen years; (3) its passing to a new owner by reason of death; [2] (4) in the case of land which is held by anybody corporate or incorporate, and which therefore does not change hands, the tax is levied every fifteen years, with the privilege on the part of the owner of paying in fifteen yearly instalments. On each of these four occasions the site value of the land is determined, and the excess, if any, of the site value thus ascertained (commonly called the occasion site value) over the original site value constitutes the increment value. An increment value of ten per cent is not taxable; but on the excess of all increments of value over ten per cent a tax is imposed at the rate of twenty per cent. In other words, the tax amounts to a fifth of any periodical increase in value over ten per cent. "The original site value" is the site value as of April 30, 1909; and on each successive "occasion," when the site value is compared with its original value, credit is to be allowed for the duty paid on previous occasions. The balance, called the "duty unsatisfied," is therefore really a tax on the entire increment since the last settlement. In case of a fee simple of land, the calculation is easy; but where the interest is less than the fee simple, the duty collectible is proportionately reduced, the balance ultimately going to the exchequer as occasions which affect the other interests in the land may arise.

[1] This period was increased to twenty years by the Revenue Act of 1911.

[2] An interest expectant on the termination of a life or lives is not an interest in land within the meaning of the law. When a life tenant dies, the full tax is payable; but when the land is subject to a settlement, the duty may be charged on the land by the persons liable to pay. Moreover, increment-value duty on death is not payable more than once during the continuance of the settlement.

In order to provide for any possible hardship arising from a depreciation in the value of the land, it is provided that when land has been sold or leased within twenty years preceding April 30, 1909, there may be substituted for the original site value one based on the consideration for the sale or the sum secured by mortgage. The Revenue Act of 1911 still further extends this concession and permits a substitute site value based on the purchase price paid by the owner of the land or of any interest therein at any period during his lifetime, provided he is still the owner at the date of application.

The exemptions from increment-value duty include: (1) agricultural land, while that land has no higher value than its market value at the time for agricultural purposes only; (2) small houses and properties which have been in the occupation of the owner for twelve months, provided that he does not own more than fifty acres in all and that the land does not exceed seventy-five pounds an acre; (3) land held by a body corporate or incorporate and used for games or recreation; (4) the lease of tenements or flats in an apartment house. The tax is paid by stamps, as a stamp duty; and in case of sales or leases a stamped instrument must be presented showing that the tax has been paid or that it is not payable. In the case of transfers arising from death, the increment-value duty is to be collected in accordance with the provisions governing the payment of the estate duty.

The third of the land taxes is the so-called reversion duty, which is payable at the termination of any lease of land. It is a tax of ten per cent on the value of the benefit accruing to the lessor by reason of the termination of the lease. The value of the benefit is ascertained by taking the total value of the land at the time the lease terminates, less such amount as is attributable to work done or capital invested by the lessor, and deducting from the balance the value of the land at the time the lease was originally made, as ascertained on the basis of the consideration for the lease. The reversion duty is not charged on agricultural land nor on leases under twenty-one years nor when the reversion has been purchased before 1909, and the lease terminates within forty years of the purchase date otherwise than by agreement between lessor and lessee. The duty is payable by the lessor, who is required, on the termination of the lease, to give particulars of the land and his estimate of the benefit accruing. Provision is also made that reversion duty

and increment-value duty shall not both be paid on the same increase of value.

In the fourth place, the new law provides for a so-called mineral-rights duty, which is a tax of five per cent on the rental value of all rights to work minerals and of all mineral way leaves.[1] From the taxable minerals, however, clay, brick, earth, sand, chalk, limestone and gravel are excepted. The tax is assessed on the proprietor or immediate lessor, and if the latter is himself a lessee he is entitled to recover by deducting the tax from the rent paid.

In the case of mineral lands neither undeveloped-land duty nor reversion duty is payable. So far as increment-value duty is concerned, minerals are not subject to the tax so long as they remain unworked. If, however, they begin to be worked after 1909, increment-value duty becomes payable in any year in which the output of the mine, as reflected by the royalties paid in the year, exceeds eight per cent of the capital value of the minerals. In computing this increment value, an allowance is made for any portion of the rental value which represents a return for sums expended within fifteen years by the lessor in boring or otherwise proving the minerals. When increment-value duty is paid on minerals, the amount of the tax is deducted from the mineral-rights duty chargeable in that year.

A general provision applying to all the land taxes is that, when any betterment charges (or what in America are called special assessments) have been levied, allowance is to be made therefor by deducting such charge from the increment value of the land, in the case of increment-value duty; from the site value of the land, in the case of undeveloped-land duty; and from the value of the benefit accruing to the lessor, in the case of reversion duty.

With reference to all these four land taxes, it will be recognized that their successful operation depends upon an exact valuation of the land. The requisite survey and valuation are provided for on a most comprehensive scale, their purpose being to determine the value of all land in the United Kingdom as it existed on April 30, 1909. The definitions of the terms used in

[1] A mineral way leave is defined as "any way of leave, air leave, water leave, or right to use a shaft granted to or enjoyed by a working lessee, whether above or underground, for the purpose of access to or the conveyance of the minerals or the ventilation or drainage of his mine or otherwise in connection with the working of the minerals."

the law, such as gross value, total value, and site value, are rather elaborate.[1] The magnitude of the task involved in making the valuation appears from the fact that the number of hereditaments in the United Kingdom amounts to about eleven millions. When the valuation books and maps are completed, they will form a record second only to the famous Domesday book of the eleventh century. The government has already set to work, and we are told that in the course of this survey there has been found an estate which has remained in the hands of the same family from the time of William the Conqueror to the present day.[2] A good beginning has been made in the process of valuation, although it will take some years before it is completed. The government estimates the cost at about two million pounds, and the time required for completing the valuation at about five years. In the meantime, naturally, the fiscal result of the new land taxes will be inconsiderable; in fact, the slight importance attached to the fiscal side of the new taxes was among the cleverest moves of the government in its contest with the landed interest, for it prevented the landowners from raising the cry of hardship. At the same time, the new taxes are expected ultimately to yield a substantial revenue; some competent authorities estimate it as likely to amount, at the present rate, to between five and six million sterling annually. It was originally proposed to devote one-half of the proceeds to

[1] A summary made by the office of internal revenue is as follows:

Gross value is the market value of the land in its existing condition.

Full site value is gross value less the difference between the gross value and the value of the cleared site.

Total value is gross value less the depreciation due to any burdens which have the effect of permanently diminishing the value of the land.

Assessable site value is total value less (*a*) the difference between gross value and full site value; (*b*) any enhanced value due to expenditure on development, appropriation for public purposes or redemption of permanent burdens, *etc.*, on the part of persons interested in the land; (*c*) the expense of clearing the site, where this is necessary for the purpose of realizing the full site value.

Speaking generally, therefore, gross value and full site value represent respectively the value of the site covered and the site cleared without reference to burdens or restrictions. Total value corresponds approximately to market value. Assessable site value represents the price which the cleared site would fetch if the permanent burdens remained and none of the outlay incurred by the owner in developing or otherwise improving the site had been expended. *Cf. Fifty-fourth Report of the Commissioners of His Majesty's Inland Revenue* (1911), p. 150.

[2] The details of both valuations, separated by almost nine centuries, are printed in the appendix to the report cited in the preceding note.

the relief of local taxation. This plan, however, was abandoned before the law was enacted, and the consideration of the point was deferred until the time when the relations between local and general finance are readjusted.[1]

From this brief survey of the provisions of the budget it will be recognized that England is putting herself at the head of those nations which are seeking to realize the importance of the newer considerations in the theory of taxable capacity. In some respects the reform is not so drastic as it might at first appear; for in that part of the budget which aroused the greatest opposition, namely, the undeveloped-land duty, England, as is pointed out above, had been lagging behind some other countries. The introduction of a tax on the capital value of land, irrespective of its rental value, merely puts England in a position which has long since been achieved, for example, by the United States. In the matter of the unearned-increment duty, also, England had been preceded by several of the German towns. But taking it as a whole, the English system is in advance of that in any other leading country. For it applies to the income tax both the principle of differentiation and that of graduation, of which only the one or the other is found in other countries; and it introduces into the inheritance tax a scale of progression more drastic than it has thus far been found possible to secure elsewhere.

It will be seen, therefore, that England is attempting to realize the more modern social ideals in taxation. In the first place, so far as the great mass of indirect taxes are concerned, England not only retains, but increases, those particular indirect taxes whose social effects may be considered on the whole relatively innocuous. It does not attempt to revert to the discarded system of the past, but confines itself virtually to the three great categories of spirits, tobacco and stamp taxation. It thus spreads over the community as a whole the burdens of a system of taxes which tends to decrease the weight of the direct taxes. Secondly, in the case of the direct taxes, England is approaching the realization of the social ideals contained in the modern theory of faculty or ability to pay. For the modern conception of ability to pay includes far more than the sacrifice theory as formulated by John Stuart Mill. The sacrifice theory looks primarily at the disposition of a man's wealth; the newer idea

[1] As to this point, see J. Watson Grice, *National and Local Finance* (London, 1910), and Sydney Webb, *Grants in Aid*, London, 1910.

is that of privilege, which looks at the acquisition of the wealth. The older doctrine was a consumption doctrine; the newer doctrine is a production doctrine. The modern theory of ability to pay is a compound of both elements. The sacrifice theory is seen in the various applications of the idea of progression or graduation of taxation. The privilege theory is seen primarily in the system of differentiation as applied to the income tax and in the increment-value duty.

The English budget, therefore, is not to be regarded as a triumph for the single taxers. It accepts indeed a small part of the single-tax reasoning, but it refuses to be bound by its narrow limitations. It adopts the idea of privilege, which the single taxers have done such good work in spreading, but it declines to confine itself to the particular form of privilege, the abolition of which is so dear to them. The English budget not only generalizes the conception of privilege, but combines with it that of sacrifice; and the result is a scheme of taxation which is, on the whole, in advance of that existing anywhere else in the civilized world and which, in some of its elements at least, may well serve as a model for the United States.

The forces which are responsible for Lloyd George's budget are gradually leavening the life of all modern civilized societies; and the translation into the fiscal sphere of these social forces cannot much longer be delayed, whether in America or on the European continent. The new English laws are, at bottom, the fiscal expression of a great social development.[1]

III. *Germany*

As in all Federal states, the fiscal problem in Germany is three-fold, dealing respectively with national, state and local finance. The reforms of 1891–93, which have been described in the preceding chapter, were concerned primarily with state and local finance. The reforms of 1909–10 deal more particularly with federal finance. But the problems of federal finance are so closely interwoven with those of state and local finance

[1] Note to 9th ed. The enforcement of the land-value laws met with such determined opposition, that all further attempts to proceed with the valuation of land and to enforce the laws were discontinued in 1920, on the ground that the expenses of administration exceeded the revenue. The total revenue from the increased value, the reversion, and the undeveloped land duties for the first four years was £1, 390,000 and the cost of valuation was £2,178,397. Then came the war, and a further disorganization. *Cf. Report from the Select Committee on Land Values*, 1920, p. 78.

that in order to obtain a clear understanding it is necessary to consider them together.

The characteristic features of the Prussian reforms of 1891–93, recounted in the preceding chapter, were the replacement of the old state taxes on produce by a modernized income tax, and the addition to the income tax of a light supplementary property tax. This property tax was designed to secure a differentiation of the income tax by imposing a somewhat heavier burden upon income from property than upon those incomes which in England are described as earned. The movement so successfully inaugurated by Prussia gradually spread throughout the empire. Bavaria, which was the last of the large German states to adopt the income tax, took this step in 1910, and the same year marked the adoption of the supplementary property tax in the smaller states of Sachsen-Meiningen and Sachsen-Weimar.[1] At the beginning of 1912 the general income tax existed in all the twenty-five German states, except the two Mecklenburgs, while the supplementary property tax had been introduced in nine states, including Prussia, Saxony, Hessia and six of the smaller commonwealths.

Side by side with this general movement came, although a little later, the gradual adoption of a system of state inheritance taxes. The law of 1891 in Prussia had indeed reformed the older system of probate fees, and had introduced a light tax on collateral inheritances with rates graduated from one to eight per cent, according to the degree of relationship. It was not until 1899 that Baden introduced a very slightly progressive direct-inheritance tax. From this time on, until 1906, when the imperial government intervened, many of the German states levied direct-inheritance taxes, with progressive scales that gradually became steeper and steeper. Thus in general it may be said that, in view of this double movement toward income and inheritance taxes, the German reform of state taxation was proceeding along the lines of faculty or ability to pay.

When, however, we come to consider federal taxation, the story is a very different one. The reform of 1909 cannot be understood without giving a short review of federal finance.

[1] An account of the development in the separate states to the end of the year 1909 is to be found in Seligman, *The Income Tax*, part I., book 2, chapter 1, of paragraph 6. In the same chapter will also be found a detailed account of the minor changes introduced into the Prussian income tax by the laws of 1906 and 1909.

Prior to the establishment of German political unity, customs duties had been collected for the common account of the German Customs Union. In 1867, when the North German Federation was organized, and in 1871, when the German Empire was established, these duties and the other common receipts of the Customs Union were assigned to the federation, respectively to the empire; and it was provided that until the federal government should levy independent taxes of its own, the federal expenses should be met by contributions from the various states. These contributions, analogous to the American requisitions during the period of the first constitution from 1781 to 1789, are known as *Matricular-Beiträge.* During the seventies, although "extraordinary" income to the amount of nearly 3,000 million marks was drawn from the French war indemnity, it was found necessary to collect such contributions from the states: from 1872 to 1878 inclusive they averaged nearly 65 million marks annually.

After 1879, however, in consequence of the higher customs duties established in that year, the direct receipts of the empire became greater than its expenditures. The state contributions to the empire, which were now obviously unnecessary, were nevertheless retained, largely for political reasons; and the following somewhat complicated arrangement was established: the surplus of all revenues from imports and from the federal excise on tobacco, in excess of 130 million marks, was assigned or allotted to the separate states; the state contributions needed to balance the imperial budget were charged against the several states and set off against their respective allotments (as both allotments and contributions were distributed *per capita* of the population, the set-off was perfect); and any surplus of allotments over contributions was paid to the states. Contributions charged against the states under this arrangement were, a little later on, called "covered" contributions, because exactly covered by the allotments; while any additional contributions over and above the allotments received the name of "uncovered" contributions. But for years, as just explained, all the contributions were covered contributions. It was really a matter of bookkeeping, as no *Beiträge* were actually paid by the states after 1879, the states receiving in cash the balances of their allotments over their contributions. During the ensuing years these balances grew, because certain surpluses of other federal taxes (stamp taxes and taxes on spirits) were also as-

signed to the states. It should be noted that all the federal taxes that had been imposed up to 1891 were indirect taxes.

During the last two decades of the century the states thus received, through federal grants, more than was charged to them in the way of contributions; and from 1896 to 1900 laws were passed from year to year regulating certain details of the surplus allotment to the various states. By the end of the century, however, a change took place. The increasing expenditures of the empire, especially for armaments, changed the surpluses into deficits, and the various states had now again to make uncovered contributions or actual *Beiträge* to the empire. Moreover, the system of federal grants to the states began to introduce considerable confusion into the state budgets, as the states could never tell beforehand exactly how much was coming to them. Accordingly, in 1904, the system of federal grants was abolished, so far as the surpluses from customs and the tobacco tax were concerned, leaving only some of the stamp taxes and the spirits tax subject to the old arrangement.

In the year 1906 the increasing needs of the imperial government led to the adoption of a number of new federal taxes, so that the system henceforth included, in addition to the customs duties, internal taxes on tobacco, sugar, salt, champagne, beer, playing cards and spirituous liquors and stamp taxes on securities, sales, lotteries, railroad freight receipts and passenger tickets. An important feature of the law of 1906 was the introduction of a federal inheritance tax, from which direct descendants were exempt. The rates varied from four to ten per cent, according to the degree of relationship; and in the case of inheritances of over 20,000 marks additions to the respective rates were imposed, rising, in the case of inheritances over one million marks, to two and one-half times the original rate. The tax was to be levied, however, by the separate states, subject to the federal law governing double taxation, and subject also to supervision on the part of the imperial authorities. Two-thirds of the yield of the inheritance tax was to go to the empire, one-third to the separate states, which now were to abandon their own inheritance taxes. It was, however, provided that for a few years, each state should be guaranteed against any loss of revenue from the readjustment. So far as the indirect taxes were concerned, the old system of federal grants to the states was retained only in the case of spirituous liquors and the stamp taxes on securities, sales and lotteries. The law of 1906 also provided for a postpone-

ment (*Stundung*) in the payment by the states of their contributions, whenever the excess of these contributions over the federal grants should amount to more than 40 *pf.* per head of population.

The immense outlays for the navy, however, caused such a deficit in the imperial finances and promised to be such a burden on the states, through calls for contributions, that it became necessary to readjust the whole system.[1] It was generally recognized that an additional independent federal revenue of 500 million marks a year had become imperative. It was also conceded that the greater part of this addition must come from indirect taxes, the government itself proposing that 400 of the 500 millions should be derived from this source. As regards the remaining 100 millions, the government suggested an imperial inheritance tax, to be extended to direct descendants, and with rates on other relatives considerably higher than under the existing law. The exact proposal was to add to the existing inheritance tax, which was payable on the individual shares, a tax on the whole estate, like the English estate duty, with rates ranging from one-half of one per cent, to three per cent. The project included the interesting provision that where the estate had previously passed within five years the tax should not again be levied, and that when the estate had previously passed within ten years only one-half of the rates should be imposed. It was also proposed to secure for the federal government some revenue from the increment-value land taxes, which, as we shall see, had been rapidly developing throughout Germany.

The government proposals were met by counter-proposals on the part of the large landed proprietors, who vigorously objected to the new estate duty. A heated discussion ensued, accompanied by a deluge of literature.[2]

[1] For a good statement of the situation see Professor Adolf Wagner's *Die Reichsfinanznot und die Pflichten des deutschen Volks mit seiner politischen Parteien. Ein Mahnwort eines alten Mannes.* Berlin, 1908. Professor Wagner suggested that a part of the needed revenue should come from an imperial income tax.

[2] The best account of the government proposals is contained in *Die Reichsfinanzreform: Ein Führer*, consisting of essays by prominent publicists, and published by the Vereinigung zur Förderüng der Reichsfinanzreform, 2 vols. Berlin, 1909. Many other books or pamphlets, all with the same general title *Die Reichsfinanzreform*, or *Zur Reischsfinanzreform*, were published by professors, officials, prominent business men, *etc.* Among the most important were those of Minister Sydow, Graf zu Reventlow, Dr.

The government was ultimately compelled to abandon the proposed taxes on wine, gas lighting and advertisements, to reduce the increase of the beer tax by about one-half, and to give up the project of an inheritance tax. This last fact led to the resignation of the imperial chancellor. The law, or properly speaking the laws, of 1909, as finally adopted, provided for three classes of measures: the raising of the requisite additional revenue; the settlement of the fiscal relations between the empire and the states; and the adoption, in principle at least, of an imperial tax on the so-called unearned increment of land. Let us consider each of these in turn.

The most important point about the provision for the additional revenue is that the needed increase, namely, 500 millions, was derived entirely from the new or augmented indirect taxes, with the exception that 25 millions were to be secured by a slight addition to the *Matricular-Beiträge*, and by the turning over to the empire of three-fourths, instead of two-thirds, of the existing inheritance tax. In detail the sources of the additional revenue and the amounts derived from each source were as follows:

TAXES	MILLION MARKS	TAXES	MILLION MARKS
Beer	100	Securities	22½
Spirits	80	Electric and other lamps	20
Tobacco and cigarettes	43	Railroad tickets	20
Transfers of real estate	40	Tickets and receipts of bank deposits (stamp tax)	10
Tea and coffee imports	37	Sparkling wine	5
Sugar	35	Minor stamp taxes	10
Dividends and interest (*Talonsteuer*)	27½		
Matches	25		
		Total from taxes	475
Increase of state contributions and of proportion of inheritance tax			25
		Total additional revenue	500

Bendixen and Professors Wagner, Schmoller, Lamprecht, Brentano, Schanz and von Heckel. A complete list of this literature will be found at the end of volume ii. of the publication mentioned at the beginning of this note. *Cf.* also Fritz Schumann, "Die Reichsfinanzreform," in *Finanz-Archiv*, vol. 27 (1910), pp. 201–245, followed by a reprint of the successive laws themselves on pp. 246–393. See also Lenschmann, *Die Reichsfinanzreform*, Berlin, 1909; and A. Hesse, "Die Reichsfinanzgesetze von 1909," in Conrad's *Jarbücher*, vol. 38 (1909), p. 721 *et seq.*

All these were either new taxes or additions to old taxes, with the exception of the taxes on sugar and railroad tickets. As to sugar, a previous law (1908) had provided that the existing tax should be lowered, beginning in 1909, from fourteen to ten marks per 100 kilograms,—an estimated reduction of about thirty-five million marks. The new law of 1909 provided that this reduction should not go into effect until 1914, thus retaining a revenue of thirty-five millions. In the same way it had been originally decided to drop the tax on railroad tickets; but the new law continued this tax and thus retained twenty millions of revenue.

Of the new or additional taxes, the most important was that on beer. The imperial beer tax had not been applicable to Bavaria, Wurtemburg or Baden, which had reserved the right of levying independent taxes on beer. The law of 1909 not only applied to the whole empire but considerably increased the tax. The old rate of 1.70 marks per hectoliter, changed in 1906 to vary from 1.68 to 2.50 marks, was now raised to 4.30 marks.

In the case of spirituous liquors, the government first endeavored to introduce a fiscal monopoly, reverting to a scheme that had been originally introduced in 1886. When the monopoly project was defeated, it was found desirable not only to increase but to simplify the existing taxes. The South German states had been subject to the imperial taxes on spirits since 1887, but there had grown up a whole code of taxes on raw material, on process and on product (*Maischbottichsteuer*, *Branntwein-Materialsteuer*, *Brennsteuer* and *Verbrauchsabgabe*). Of all these taxes only one, namely, the tax on the product itself (*Verbrauchsabgabe*) was retained, but it was now materially increased from 50–70 marks per hectoliter to 105–125 marks, according as it was within or without the "contingent."[1] The

[1] This "contingent" arrangement is very complicated. When the spirits tax was increased in 1887 to 70 marks per hectoliter of pure alcohol, it was expected that the price would fall because of the falling off in the demand. In order, therefore, to compensate the distillers, the tax was reduced to 50 marks for a part of the domestic demand, and the spirits subject to this lower tax were called the "contingent spirits." It was expected that the price of the whole output would conform to the higher tax of 70 marks on the non-contingent part of the supply, and that therefore the domestic distiller would get a bounty of 20 marks on the corresponding part. This bounty was the so-called "love contribution" (*Liebesabgabe*). It was further supposed that if there should be such a change in the domestic

tax was also graduated according to the size of the distilleries and a distinction was made between agricultural and industrial distilleries.

In the case of tobacco, the old taxes on leaf, were increased, for the uncured leaf from 36 to 45 marks, and for the cured leaf from 45 to 57 marks, with the provision that in case of very small fields a tax on the area of the land (four and one-half *pf.* for every square metre) should be substituted. In the case of cigarettes the tax was increased so as to vary from two to fifteen marks per thousand, with separate taxes on cigarette paper and cigarette tobacco. Finally, the import duties on tobacco were considerably increased.

The attempt to levy a general tax on all wine came to a disastrous end. All that could be done was to increase the tax on sparkling wine which had been imposed in 1902 at the rate of from 10 to 50 *pf.* per bottle, so that from now on the upper limit of the tax was three marks per bottle. Of the other taxes, the stamp tax on securities was raised from the old rate (six-tenths of one per cent to three per cent) to two to five per cent; and the stamp tax on transfers of real estate was increased from one-third to two-thirds of one per cent, to continue until a tax on land increment value should be introduced. In addition to these increases in the old taxes, new taxes were laid on petroleum, six to ten marks per 100 kilograms; on electric lamps, 5 *pf.* to one mark per lamp; on matches, one to five *pf.* per box; on

demand that none of the 70 marks tax on spirits should be needed, the price would then fall and the bounty disappear.

As a matter of fact there always remained a difference of 20 marks in the price between the contingent and the non-contingent spirits; and since two million hectoliters were used, the bounty amounted to 40 million marks, the so-called *Vierzig Millionen Geschenck*. But, as the demand fell off, the price did likewise, so that the distillers really made no more than before.

The details of the "Contingentierung" were changed from time to time. In 1887 the contingent was fixed at four and one-half liters per head of population every five years. But this turned out to be unsatisfactory because the demand for liquor stood in no relation to population. Therefore the *per capita* calculation, which varied the contingent according to the amount of alcohol produced, was modified according to changes in the process of manufacture, the amount of land employed, the size of business, *etc.* In 1902 further modifications were made. By the new law of 1909 the total contingent was fixed for two years at 2,309,212 liters of pure alcohol, being apportioned to each state according to a series of complicated rules.

checks, ten *pf.;* and on dividends and interest (the so-called *Talonsteuer*),[1] one per cent.

It will be seen that Germany has gone much further than Great Britain in its reliance on indirect taxes. It can hardly be doubted that Germany overshot the mark in refusing to accept the inheritance-tax project. Indeed it is not at all improbable that before long the original scheme will reappear. But even with the possible adoption of the inheritance tax, it is obvious that the great mass of the additional revenue will still come from indirect taxes.

The second point in the new German law was the settlement of the contribution question. It will be remembered[2] that just before the new law went into effect there were no less than three kinds of *Matricular-Beiträge:* first, the "postponed" contributions referred to above; second, the contributions covered by the return grants from the empire to the state; and third, the uncovered contributions, amounting to forty *pf.* per head.[3] The postponed contributions were now abolished, and the outstanding amount of 144 million marks was assumed by the empire, to be funded into imperial debt. As to the second category, it was provided that there should henceforth be only one class of imperial grants (*Ueberweisungen*), namely, those consisting of the net yield of the tax on spirits mentioned above. Finally, the uncovered contributions were increased to eighty *pf.* per head. Since, however, the individual states were henceforth to retain only one-fourth instead of one-third of the inheritance tax, it was provided that if the excess of contributions over grants amounted to more than a sum fixed for the first year at 48,512 million marks, and changing thereafter according to the *per capita* provision just mentioned the surplus should be defrayed at first out of a loan and then, after April, 1911, out of imperial funds.[4]

The third important point in the new legislation was the adoption, in principle at least, of an imperial tax on the unearned

[1] The *Talonsteuer* was imposed on *Gewinn-Anteilscheine* and *Zinsbogen* (coupon sheets). The "talon" is that part of the coupon which entitles the bearer to a series of new coupons when the coupons are exhausted before the due date of the bond.

[2] *Cf. supra*, page 498.

[3] *Cf. supra*, p. 500.

[4] The excess of such contributions over imperial grants which had remained at about 24 million marks from 1902 to 1906 rose to 88 millions in 1907, to 150 millions in 1908 and to 232 millions in 1909.

increment of land. This matter is so important as to deserve a separate section.

IV. *The German Tax on Unearned Increment*

When this matter came up for discussion in parliament it was soon recognized that more time would be needed to work out the details of an adequate law. It was therefore decided to accept only the principle of the tax and to postpone the enactment of the law until 1911, filling up the gap in the budget by a temporary stamp tax on sales of real estate. It was found desirable, however, for various reasons, to expedite the preparation of the bill, which was finally enacted into law February 14th, 1910.

Hitherto, with few exceptions, increment-value taxes on land had been levied only by municipalities.[1] The tax was

[1] A good account of these taxes will be found in the report by Bernard Mallet, "The Taxation of Increment Value in Frankfort and other German States," in the blue book entitled *Taxation of Land, etc. Papers bearing on Land Taxes and on Income Tax, etc., in certain Foreign Countries, and on the Working of Taxation of Site Values in certain States of the United States and in British Colonies, together with Extracts relative to Land Taxation from Reports of Royal Commissions and Parliamentary Committees.* (Cd. 4750) London (1909). *Cf.* Y. Scheftel, *The Taxation of Land Value.* Boston, 1916, which includes chapters on Great Britain and Australasia.

In Germany the fullest account will be found in the successive numbers of the quarterly periodical, *Jahrbuch der Bodenreform*, edited by A. Damaschke. *Cf.* especially the article by Professor Adolf Wagner, "*Zur Rechtfertigung der Wertzuwachssteuer*, in vol. ii. (1906). Among the earlier works the most important are Adolf Weber, *Ueber Bodenrente und Bodenspekulation in der modernen Stadt*, Leipzig, 1904; R. Brunhuber, *Die Wertzuwachssteuer in Praxis und Teorie*, Jena, 1905; Wesselski, *Die Beteiligung der Stadtverwaltung am Boden-Wertzuwachs*, Berlin, 1905; Pabst, *Die Idee einer Besteuerung der Konjunctur-Gewinne an Grundstücken und Gebäuden*, Berlin, 1906; Baumeister und Jäger, *Die Wertzuwachssteuer*, Berlin, 1906; J. V. Bredt, *Der Wertzuwachs an Grundstücken und seine Besteuerung in Preussen*, Berlin, 1907; K. Kumpmann, *Die Wertzuwachssteuer*, Tübingen, 1907; J. H. Epstein, *Zur Verteidigung der Zuwachssteuer*, Berlin, 1907; M. Diefke, *Die Wertzuwachssteuer*, Berlin, 1908. Perhaps the best of all these earlier works is that of D. Boldt, *Die Wertzuwachssteuer*, 3d edition, Dortmund, 1909. Among the later works are those of Keller, *Die Besteuerung der Gebäude und Baustellen insbesondere Wertzuwachssteuern*, Berlin, 1910; H. Weissenborn, *Die Besteuerung nach dem Wertzuwachs*, Berlin, 1910; and J. S. Steiger, *Die Wertzuwachssteuer in Deutschland und der Schweiz*, Zürich, 1910; *Cf.* also Fabrizio Natoli, *L'imposta sull' incremento di valore del suolo urbano*, Palermo, 1908; T. Becu, *Impuestos al mayor valor de la propriedad immueble*, Buenos Aires, 1914; M. Petsche, *Les plus values. Base d'imposition*, Paris, 1919.

first imposed in the German colony of Kiauchau in 1898. When the German government took over that possession the Admiral in charge, von Diederich, was much concerned over the difficulties that had developed in some of the Asiatic colonies, and especially in the cities opened to the world's trade by China in 1895, where a few speculators had bought up much of the land for ridiculously small sums and then held it for sale to Europeans at very high prices. The German government was about to make large outlays in constructing harbors, erecting government buildings and building railroad stations and factories. The admiral, foreseeing a great rise in land values thought that it would be desirable for the government to purchase a large part of the land and then sell it to intending purchasers as might be needed. With this object in view, he issued, on the very day of occupancy, November 14, 1897, a proclamation forbidding any transfer of land without the authorization of the government. As the immediate purchase by the government turned out, however, to be impracticable, the admiral contented himself with obtaining from the native holders, by offering them a remission of a certain part of the annual land tax, an option on the land at prices existing at the time of occupation. As the land, however, even if not in possession of the government, was sure to increase in value almost entirely because of the prospective outlay by the government, an official memorial of April, 1898, suggested that no future transfer of land should be permitted without the authorization of the government, which should also participate in the profits. The ideas of the memorial were carried out in the famous land ordinance of 1898. This provided that whenever any plot of land in the colony was sold, one-third of the increase in its value, after deducting any improvements in or on the land made by the owner, should be paid to the government; and that in case the land was not sold, it should be valued every twenty-five years and one-third of any increase in the value be similarly paid to the government. The first was called the direct increment tax (*direkte Zuwachssteuer*), the second, the indirect increment tax.[1]

[1] The "Landordnung" of Kiauchau is printed in full in the first number of the *Jahrbuch der Bodenreform*, 1905, p. 66. A thorough study of the entire matter is made by Dr. W. Schrammler in two articles: "Die Landpolitik im Kiautschougebiet," and "Die Steuer-politik im Kiautschougebiet," in the same periodical, vol. xvii. (1911), pp. 1–62, and vol. viii. (1912),

Neither the official who was primarily responsible for the plan nor the admiral who put it in force was acquainted with the theories of either John Stuart Mill or Henry George. The measure was a purely practical one, and was designed not so much to secure fiscal results as to prevent speculation on the part of the Chinese and the acquisition of the best land by private individuals. In fact, the yield of the tax was negligible, the greatest revenue, secured in 1901–02 amounting to only $2,004. On the other hand, since the land was sold only to those who guaranteed to build at once, the speculator was effectually discouraged.

The Kiauchau experiment at once attracted the attention of the land reformers in Germany. The German Land Reform League petitioned the government to extend the principle to the other German colonies.[1] At the Colonial Congress of 1902 in Berlin the success of the scheme was emphasized, and as a result the possibility of applying the plan within Germany itself began to be discussed in the press.

The situation in Germany was peculiar. The cities were growing with a rapidity exceeded perhaps nowhere in the world, and there was accordingly great opportunity for speculative activity. The German tax system, moreover, played peculiarly into the hands of the speculators. In the first place, although a few cities practise the system of special assessments (*Beiträge*), they are in most cases levied, not as in the United States when the improvements are made, but only when the building is erected. There is thus every inducement to keep the land idle as long as possible. Secondly, the land tax is not assessed on the selling value of the land, as in the United States, but on its assumed produce or yield. Moreover, the calculation of the estimated yield of the land used for agricultural purposes is revised only at long intervals, in Prussia, *e.g.* every fifteen years. As, therefore, the towns rapidly encroach upon the agricultural suburbs, the land continues for a long time to be assessed, notwithstanding its enormous rise in value, according to its assumed produce as so-called "potato land." The result, of course, is to offer every inducement to the speculator to keep land out of use. As a consequence, German

pp. 1–68. Here will also be found a reprint of the memorial or *Denkschrift über Land und Steuerwesen.*

[1] The German Land Reform League issued *Zur Landfrage in den Kolonien*, 1899; and *Kamerun oder Kiautschou*, 1900

towns, especially those of moderate size, have been confronted by a housing problem (*Wohnungsnot*), such as is found nowhere else in the civilized world. For in England the cities have not grown at quite so rapid a pace, and in the United States the practice of assessing the real property tax, on the basis of actual selling value coupled with the system of special assessments, which imposes a heavy burden on the land before the building improvements are made, effectually prevents the German abuses. In Germany, therefore, since the beginning of the twentieth century a great literature has arisen on the housing problem as connected with the fiscal question.[1]

The reform movement assumed two forms. The first was to introduce a tax on the selling value of real estate (*Steuer-nach dem gemeinen Wert* or *Besitzsteuer*), either in place of the existing tax on assumed produce or in addition to it. In a few cities such a tax has now been introduced, although at a far lower rate than is customary in American cities and with correspondingly less effect in removing the evils of the situation.

The second phase of the reform was the introduction of a tax on unearned increment, based on the Kiauchau experiment discussed above. The first city to introduce the increment-value tax was Frankfort a. M. which initiated the system in 1904. In the following year Cologne and Gelsenkirchen, and in 1906 Dortmund and Essen adopted the scheme. From that time on, the movement spread rapidly throughout Germany: by April, 1910, the increment-value tax was found in about 4,500 cities and towns, including about one-fourth of the entire population of the German empire. The tax varied in its details from place to place, but the fundamental principles were everywhere similar. As these separate taxes have now all been abolished, it will suffice to call attention to their chief features.

[1] Compare Paul Voigt, *Grundrente und Wohnungsjrage in Berlin und seinen Vororten* (Jena, 1901); Adolf Weber, *Ueber Bodenrente und Bodenspekulation in der modernen Stadt* (Leipzig, 1904); Fuchs, *Zur Wohnungsfrage* (Leipzig, 1904); R. Eberstadt, *Die Spekulation im neuzeitlichen Städtebau* (Jena, 1907); and *Handbuch des Wohnungs wesens und der Wohnungsfrage* (Jena, 1911); K. von Mangoldt, *Die städtische Bodenfrage* (Göttingen; 1907); O. Gutzeit, *Die Bodenreform* (Leipzig, 1907); J. von Bredt, *Die National-Oekonomie des Boden* (Berlin, 1908); Adolf Weber, *Boden und Wohnung* (Leipzig, 1908); and W. Gemund, *Bodenfrage und Bodenpolitik* (Berlin, 1911).

The increased value on which the tax was applied was generally interpreted to mean the difference between the last purchase price and the present selling price. Allowance was almost universally made for expenditures incurred in the improvement of the land and for the cost of new buildings or rebuilding. Allowance was also usually made for a sum equivalent to the stamp tax, the transfer tax and other fees connected with the change of ownership. A further sum was usually allowed representing the interest (not compounded) from the time of the last sale to the present transfer. In some places these sums, especially the cost of improvements, were subtracted from the selling price, while in others they were added to the purchase price. In some places again, where certain parcels of an entire tract owned by a single individual had been sold at a loss, allowance was made therefor, provided that the losing sales occurred at the same time as those that were profitable, or within a limited period previous thereto. In most cases, again, slight increases of value were exempted. The tax applied in general only to increments of value exceeding ten per cent; sometimes, however, it began only at twenty per cent, and in Frankfort only at thirty per cent. The rates were almost always progressive, but the minima and maxima varied greatly. Thus in Hamburg the rates were graduated from one to twelve and one-half per cent, while in Cologne they rose from ten to twenty-five per cent. In Gelsenkirchen the maximum was thirty per cent. The scale of progression, moreover, varied considerably, from one per cent for each ten-per-cent increase of value, as in Cologne, up to ten per cent for each five-per-cent increase in value in some other cities. The maximum limits varied still more widely: in Paderborn, for instance, the highest rate (fifteen per cent) was imposed in case of an increase of value of over seventy-five per cent, while in other towns the increase of value taken into account in determining the rate was considerably higher, rising in some cases to two hundred per cent. The highest tax imposed anywhere was thirty per cent where the increase of value was over one hundred and fifty-five per cent.

Owing to the short time that these local taxes had been in force the fiscal results were not pronounced. But the taxes approved themselves on the whole to the authorities and the system was beginning to spread even to the state governments. A bill for a state increment-value tax was introduced in Bavaria

in 1909, and in January, 1910, the first state increment-value tax was established in Lippe-Detmold.[1]

The project of an imperial tax on increment value was first suggested by Dr. Wilms, mayor of Posen, in a speech in the Prussian House of Lords on March 28, 1908. The scheme was at once taken up; a few weeks later it enlisted the support of Professor Adolf Wagner in a speech at a convention of land reformers. A heated discussion thereupon ensued throughout the country. The project was vigorously opposed by the various local interests that had now come to consider the unearned increment as a valuable object of local taxation. The advocates of the scheme had, however, no difficulty in showing that if site values were the result of the numbers and prosperity of the population, the empire as a whole also contributed to this prosperity and to these numbers; and that in reality no legitimate stopping place between locality and empire existed. The most that the supporters of the project conceded was that the localities had an undoubted right to a large share of the proceeds.[2]

The movement in favor of the scheme became so strong that in May, 1908, the finance committee of the Reichstag resolved to ask the government to introduce without delay a bill for an imperial unearned increment tax. Secretary Sydow stated, however, that he must first submit the whole project to the opinion of experts. The judgment of these officials was on the whole adverse, and a memorial was submitted in opposition.[3] Notwithstanding this adverse judgment, a bill was introduced and passed in a second reading on June 23d. A few weeks later, however, it was decided to postpone the enactment

[1] *Cf.* "Die erste staatliche Zuwachssteuer," in *Jahrbuch der Bodenreform*, vol. vi. (1910), pp. 49–57.

[2] The most important of the works in favor of the scheme were: Dr. Wilms, *Die Reichs-Zuwachssteuer* (1909); A. Pöhlman-Hohenaspe, *Der erste Schritt zu gesunden Finanzen* (Leipzig, 1909); A. Damaschke, *Zum Kampfe um die Reichs-Zuwachssteuer* (Berlin, 1910). *Cf.* also a series of seven articles written from the point of view of each of the various economic interest, such as agriculture, industry, commerce, building trades, *etc.*, in the *Jahrbuch der Bodenreform* vol. vi. (1910), pp. 161–229. The chief arguments in opposition were expressed by Dr. Strutz, *Betrachtungen zur Reichs-Zuwachssteuer* (Berlin, 1910); and Karl Diehl, "Zur Kritik der Reichs-Zuwachssteuer," in Conrad's *Jahrbücher*, vol. 40 (1910), p. 289 *et seq.*

[3] This *Denkschrift betreffend die reichsgesetzliche Einführung einer Wert-Zuwachssteuer für Immobilien* is printed in the *Jahrbuch der Bodenreform*, vol. v. (1909), pp. 192–203.

of the law, and for the time being a stamp tax was substituted. Nevertheless, the law contained a clause that an imperial unearned increment tax, designed to yield twenty millions of marks, should be introduced, if practicable, by April, 1911, and surely not later than April, 1912.

The prospect of an imperial tax evoked all manner of schemes on the part of the landowners, designed to frustrate or to evade the projected legislation. This, together with the urgency of the fiscal situation, decided the government to expedite matters, and a bill was introduced in April, 1910. It was referred to a committee and, after considerable discussion became law in February, 1911, but with retroactive force to December 31, 1910.[1]

The new imperial tax replaces all the former state and municipal taxes of the same kind. The law provides that, in the case of the transfer of any property interest in real estate, a tax shall be levied on the increase of value which occurs without the activity of the owner. In this statement two points are to be noticed: the tax is imposed not simply on land values, as in England, but on real estate, thus raising the question of how improvements on land are to be treated. In the second place, the words "without the activity of the owner" raise the question how far the increase of values is due, on the one hand, to the growth of the community or, on the other, to the efforts of the landholder. The

[1] The original bill with the amendments of the Commission, and of the first and second reading, is printed in the *Jahrbuch für Bodenreform*, vol. vi. (1910), p. 114 *et seq.* The law can most conveniently be consulted in *Finanz-Archiv*, vol. xxviii. (1911), p. 817 *et seq.* *Cf.* also the *Jahrbuch für Bodenreform*, vol. vii. (1911), pp. 62–85. The annotated law has been published in various annotated editions. The best perhaps, is Dr. H. Koppe, *Das Zuwachssteuer-Gesetz von Feb. 14, 1911, mit den Ausführungs-Bestimmungen des Bundesrats Preussens, Bayerns und Sachsens* (Munich and Berlin, 1911). Good discussions of the new law are those of Dr. G. Strutz, "Die Reichs-Zuwachssteuer vom sozial-politischen Standpunkte," in Braun's *Annalen für Sozial Politik und Gesetzgebung*, vol. 1 (1911), no. 1; and of M. Weyermann, "Die Reichszuwachssteuer vom sozialpolitischen Gesichtspunkte," in Schmoller's *Jahrbuch für Gesetzgebung Verwaltung und Volkswirtschaft*, vol. 36 (1912), pp. 283–303. *Cf.* also Professor Gustav Cohn, "The Taxation of Unearned Increment in Germany," in *The British Economic Journal*, vol. xxi. (1911), p. 212 *et seq.*; and R. C. Brooks, "The German Imperial Tax on the Unearned Increment," in *Quarterly Journal of Economics*, vol. xxv. (1911), p. 682 *et seq.*, with a translation of the law on pp. 751–765. In E. Peisker, *Reichswertzuwachssteuer. Das geltende Recht und die Ziele seiner Reform*, Berlin, 1912, will be found a twelve page bibliography of the topic.

small interests of the lower middle classes are exempted: the tax does not apply to any interest in real estate of less than 20,000 marks in the case of improved property, or of less than 5,000 marks in the case of vacant land; provided always, that neither the owner nor his wife had more than 2,000 marks income in the preceding year, and provided also that neither of them was engaged in the real-estate business. Other exemptions include associations for building purposes, for colonization and the like, provided that their profits are limited to four per cent. Certain transactions, moreover, are not liable to tax, such as transfers by inheritance, under certain conditions or by marriage settlement, or for the purpose of agricultural improvements, such as the redrawing of boundary lines among scattered strips of real estate (*Flurvereinigung* and *Umlegung*). In order to meet a common method of evading the tax, it is provided that any transfer of securities of a corporation whose assets consist of real estate should be considered a transfer of the land itself.

The increment of value subject to tax is defined as the difference between the purchase price and the selling price. To the last purchase price, however, the following additions are to be made: (1) Four per cent as representing the original cost of acquisition. If it can be proved that the transfer fees were more than this sum the actual cost may be substituted. (2) The amount of special assessments for opening streets, constructing sewers, *etc.*, together with interest at four per cent for not more than fifteen years. (3) If the purchase took place through the foreclosure of a mortgage, the amount of the mortgage is to be added to the equity. (4) All outlays for permanent improvements, together with five per cent on such outlay or, where the owners are engaged in the building industry, fifteen per cent of such outlay. (5) An additional amount equal to two and one-half per cent in the case of certain small properties.[1]

[1] This complicated item is clearly explained on p. 694 of the essay of Brooks mentioned above. "If the original purchase price and the permanent improvements taken together, show the property to have cost less than 100 marks an *are* ($964 per acre), or three times as much in the case of vineyard land, an amount equal to 2½ per cent per annum from the time of the purchase in the case of purchase price, and from the time of making improvements in their case shall be added. In the case of land which, on the same basis, represents a higher value per *are*, there shall be added on such excess, if unimproved, 2 per cent per annum; if improved, 1½ per cent. If the period of ownership has been less than five years, and the land has remained unimproved, these additions are reduced one-half" (*loc cit.*,

It was in connection with the question of improvements that the chief discussion took place. In some of the municipal taxes, as we have seen, the cost of improvements was subtracted from the selling price, while in others it was added to the purchase price. In many cases this did not make much difference, but in the new imperial tax the rates, as we shall see in a moment, are based on the percentages of the unearned increment to the purchase price of the property plus the cost of permanent improvements and the other additions. It is obvious that if the value of the improvements is added to the cost price, the percentage of increment, and therefore the tax rate, will be much less than would otherwise be the case. In the original draft of the bill the value of permanent improvements was subtracted from the selling price instead of being added to the purchase price. The advocates of this provision supported it on the ground that the increase of value was almost always due to a change in the value of land rather than in the value of improvements. Moreover, it must be remembered that the German law pays no attention to depreciation in the value of buildings. It is perfectly conceivable that where a fairly good house is sold a long time after its purchase, when it has become greatly in need of repair, the increase in the value of the land might be swallowed up by the decrease in the value of the house. In such a case to permit the owner to add the value of the improvement to the cost price is virtually to exempt him from the tax, notwithstanding the rise in land values. Nevertheless, in the contest that ensued, the landowners succeeded in securing a change in the bill, and the law, as adopted, permits the owner to include the cost of improvements in estimating the purchase price. This, it is obvious, greatly diminishes the rigor of the tax.

From the selling price, on the other hand, it is permissible to deduct first the costs of the sale, including fees; second, a compensation for any diminution of value that may occur after Jan. 10, 1911; and third, the amount by which the annual yield on the land, for a period of not more than fifteen years, falls short of three per cent on the original purchase price, including the improvements. This practically frees the holder of

p. 694). The object of these provisions is three-fold; first, to favor agricultural land, and especially vineyard land, where the value of the land is in part due to the efforts of the cultivator; second, to increase the tax on land that is no longer used for agricultural purposes and is "ripe" for building; third, to compensate the landholders for a rise of values which may be in part due to a decrease in the purchasing power of money.

vacant land from any tax unless the annual increment of value is more than four or five per cent.

An important section of the law provides that if the last transfer took place more than forty years previously, the value of the property at a period of forty years before the transfer is to be taken as the purchase price, unless it can be shown that the property commanded a higher value before that period. Furthermore, if the last transfer took place before the year 1885 its value at that date is to be taken as the purchase price.

The rate of the tax depends, as stated above, on the percentage of the unearned increment to the purchase price of the property plus the cost of permanent improvements and the other legal additions. Where the increment of value is ten per cent or less, the tax is ten per cent of the increment. The rate increases one per cent for every additional twenty per cent (and later ten per cent) of increment of value until it reaches a rate of thirty per cent on all increments of value of 290 per cent. A diminution of one per cent on the tax, however, is permitted for every year since the last sale; and where the last sale took place before January 1, 1900, this diminution is allowed at the rate of one and one-half per cent annually up to January 1, 1911.

The tax was to be assessed by the state authorities in each commonwealth, but under the general supervision of the imperial officials. Of the proceeds fifty per cent went to the empire and forty per cent to the locality, the remaining ten per cent being reserved by each state to cover the cost of collection. The localities, however, were permitted to levy additions to the tax, with two restrictions: they could not impose more than double their own share, and the total tax imposed in any individual case could not exceed thirty per cent of the increment value.[1]

Contrasting the German law with its English analogue, we notice not only its great complication, but the presence, in the endeavor to be just to all interests, of many awkward provisions. The differences may be summarized as follows: the tax is not one on pure land values; second, no allowance is made for depre-

[1] In 1913 the imperial land-increment tax was converted into a general property-increment tax through the *Vermögenszuwachssteuer* as a part of the new *Besitzsteuer*. The proceeds of the land-increment taxes henceforth reverted to the states and localities. The principle of the property-increment tax was again accepted in the *Reichskriegssteuer* of 1916 and in the extraordinary War Taxes (*Kriegsabgaben vom Vermögenszuwachse*) of 1918 and 1919.

ciation in the value of improvements; third, the concessions to the landowners mentioned above will seriously reduce the fiscal importance of the tax; and fourth, many of the provisions are so complex that they will undoubtedly create difficulty. With all its defects, however, the law is a striking example of progress in the conception of fiscal justice, and an evidence of the influence of modern changes in economic conditions on the forms of taxation.

If we compare the German reforms as a whole with those in Great Britain we notice some striking analogies accompanied by no less striking dissimilarities. Both countries have relied for their increasing revenues to a large extent on indirect taxes. Both countries have developed and perfected their income tax. Both have introduced somewhat similar land taxes. On the other hand, while England has further developed its inheritance tax, the German effort in the same direction was frustrated. *Per contra*, however, the adjustment of the relations between local and central finance has made more progress in Germany than in England. In the case of the taxes on transactions and consumption the British system is on the whole superior to the German. The British income tax, again, not only compares favorably with the German system in simplicity of administration and in fiscal results, but is more nearly in accordance with the modern theories of ability to pay. In the matter of inheritance taxation Great Britain is far in advance of Germany. The British land taxes, finally, are more comprehensive than the German, and the increment-value tax in particular is both more simple and more in agreement with correct theory. It is only in the single point of adjustment between local and imperial taxation or, as in Germany between local, state and imperial taxation that the British system is inferior to the German. Taking it all in all, therefore, it may be said that while the German reforms constitute an undeniable step in advance, many further steps must be taken before the German fiscal system can be declared to be on a level with the English. It is not at all improbable that the coming years have in store for Germany an improvement in the methods of the income tax and the adoption of a revised and modernized inheritance tax.[1]

[1] This prediction has been verified by the readjustment of German taxation in 1920, which brought about the revolution in the relations of federal and state taxation referred to on p. 389, *supra*.

V. *Australasia*

The recent tax reforms in Australia and in New Zealand have effected no dramatic changes like those of 1909–10 in England and Germany. The movement in the antipodes has been a continuous progress on the lines discussed in the case of New Zealand in the last chapter. The year 1910, however, is marked not only by the extension to the Commonwealth of Australia of certain taxes previously reserved for the separate states, but also by some significant changes in the laws of the states themselves. The Australasian movement may be discussed under four heads: (1) the land taxes in the states and the commonwealth; (2) the exemption of improvements in the localities; (3) the spread of the income tax; and (4) the relation between local and general finance.

The land taxes in Australasia were originally imposed partly for revenue purposes, but chiefly in order to discourage the formation of large landed estates.[1] The earliest law of this kind was enacted in Victoria in 1877. It provided for a tax on rural lands over 640 acres in extent and over £2,500 in value. It was followed by the South Australian law of 1884, with the introduction of the progressive principle in 1890.[2] In both

[1] The best account of the Australasian land taxes will be found in *The Financial Yearbook of the Commonwealth of Australia*, 1901–10, by G. H. Knibbs (Melbourne, 1911); especially in secs. vi., xix. and xx.; and in the *New Zealand Official Yearbook*, 1911, by M. Frazer, Wellington, 1911. The British Blue Books on the land taxes of Australia and New Zealand, published in 1906–07, were reprinted with additions in 1909, under the title *Taxation of Land, etc. Papers bearing on land taxes and on income taxes, etc., in certain foreign countries, and on the working of taxation of site values in certain cities of the United States and in British colonies, together with extracts relative to land taxation and land valuation from reports of Royal Commissions and Parliamentary Committees.* Cd. 4750. A synopsis of the Australian systems up to 1908 will be found in Seligman, *Progressive Taxation*, 2d ed., 1908, p. 94 *et seq.* *Cf.* also W. Pember Reeves, *State Experiments in Australia and New Zealand*, 1902, vol. i., pp. 251–268, and a later article by the same author, "Land Taxes in Australasia," *Economic Journal*, vol. xxi. (1911), p. 513 *et seq.* This article sums up his conclusions published in the Blue Book mentioned above.

[2] In Victoria the rate was 1¼ per cent of the capital value of the land. The land was, however, valued on a pastoral basis, according to sheep-raising capacity, at from £1 to £4 per acre. This, of course, meant an insignificant tax. In South Australia the law of 1890, still in force, imposes a tax of one halfpenny in the pound on the unimproved value of land and over £240 in value, with an additional halfpenny per pound for any excess over £5,000, and with 20 per cent additional for absentees, who are defined as those who have been away from the state for more than one year.

these cases, however, the taxes were light and produced no appreciable effect on the size of the estates. In the other Australian state in which the system was introduced—namely, New South Wales, the object was primarily fiscal, the law of 1895 imposing a tax of one per cent on all unimproved land.

In New Zealand a more vigorous policy was inaugurated as early as 1891, as has been explained in the last chapter. It will be remembered that the law adopted in that year provided for a tax of one penny in the pound on all land with an exemption of improvements up to £3,000; and in the case of land of the value of at least £5,000 an additional graduated tax on the value of the land, exclusive of improvements and without deduction for mortgages, the rate rising in fourteen classes until it reached 1¾*d.* in the pound (changed to 2*d.* in the pound in 1893), when the land was worth £210,000. This made the maximum rate on the largest estates 3*d.* in the pound.

This graduated land tax, however, proved ineffective from both the fiscal and social point of view. Its yield had increased only from £71,000 in 1893 to £79,000 in 1903, notwithstanding a considerable rise in the value of land. The effect of the law in cutting up large estates was correspondingly slight; it was, indeed, almost imperceptible.

It was consequently decided to increase the scale of graduation; and in 1903 an additional tax over and above the ordinary penny rate was imposed on unimproved land, the rate being graduated from one-sixteenth of a penny on land values of from £5,000–7,000 and reaching 3*d.* (one and one-fourth per cent) on land values of £210,000, with fifty per cent additional for absentees. This change, together with an improvement in the machinery of assessment increased the yield in the next three years (up to 1906) about thirty per cent.[1]

[1] The exact figures as presented in the *New Zealand Official Year Book*, 1910, p. 662, are as follows):

YEAR	ORDINARY LAND TAX	GRADUATED LAND TAX	ABSENTEES' TAX
1900–01..............	£222,353	£ 71,406	£ 825
1901–02..............	233,545	78,214	1,076
1902–03..............	217,307	77,832	923
1903–04..............	232,774	98,681	3,536
1904–05..............	254,726	94,703	3,425
1905–06..............	277,144	104,949	3,663

But while the fiscal results were gratifying, the government was not satisfied with the effect of the law in breaking up large estates. The statistics show that while there had been, up to 1906, a diminution in the estates of over fifty thousand acres, and a somewhat smaller decrease in the number of estates between twenty and fifty thousand acres, there had been virtually no falling off in estates between ten and twenty thousand acres and an actual increase in those between five and ten thousand acres.[1]

On the other hand, the increase in the number of the very small plots was largely due to laws independent of the tax system, especially the scheme inaugurated in 1892, whereby the government purchased large estates in order to lease them in small sections to intending farmers, as well as the plan by virtue of which a group of settlers might form a land settlement association, purchase an estate by means of debentures issued through a public trustee under the guaranty of the government and then subdivide it into plots of not more than 500 acres.

Accordingly in 1907 the government decided to increase substantially the rate of the tax in the case of land values over £40,000, so that the additional graduated land tax now reached two per cent at a maximum value of £200,000.[2] This change led to a considerable increase of the revenue, the yield of the graduated tax almost doubling in four years, and forming a

[1] The *New Zealand Official Yearbook*, 1910, p. 626; *ibid.*, 1911, p. 610, gives the following figures, indicating the number of farms of different sizes:

YEAR	5–100 ACRES	100–1,000 ACRES	1,000–5,000 ACRES	5,000–10,000 ACRES	10,000–20,000 ACRES	20,000–50,000 ACRES	OVER 50,000 ACRES	TOTAL
1883	14,766	14,267	1,281	203	141	83	23	30,764
1886	17,075	15,471	1,425	220	151	79	29	34,450
1889	18,805	16,743	1,413	221	134	89	27	37,432
1892	19,369	17,538	1,558	208	148	84	30	38,935
1902	20,799	20,316	2,144	260	123	70	23	43,785
1906	20,900	21,269	2,417	278	129	62	13	45,068
1911	21,767	21,924	2,753	307	121	39	11	46,922

[2] The scale of the additional taxes on unimproved land value over and above the ordinary penny rate was fixed in 1907 as in the table printed on the following page.

continually growing percentage of the entire public revenue.[1] Even this, however, did not satisfy the public, and it was provided that, after 1910, on all land other than that used for business premises, the graduated scale should be increased by twenty-five per cent. The result is that the total land tax now rose to three and one-half per cent in the case of residents, and to six per cent in the case of absentees. In 1917, 50% was added to the graduated land tax, increasing the old rate of 1*d.*–7*d.* to a maximum of 10½*d.* (4 1/3%) for residents, and to 14*d.* (5 4/5%) for non-residents. The total land tax thus reached 5 1/3 and 6 4/5% respectively. Whether these increased rates will suffice to attain the objects of the law in greater measure than has hitherto been the case, remains to be seen. The figures of land-holding for 1911, as compared with those of 1906, show a decided falling off in farms of from 20,000 to 50,000 acres, but a virtual standstill at both extremes.

What may be called the New Zealand system of land value taxes, has been spreading through other parts of Australasia during the last few years. In a few cases indeed the system is still but slightly developed. Thus, in South Australia where the rates were increased in 1903 and 1905, the law of 1906

[1] The rates of 1907 were as follows:

LAND VALUES	RATE (PER £)	LAND VALUES	RATE (PER £)
£ 5,000– 7,000....	1–16*d.*	£20,000–22,500....	8–16*d.*
7,000– 9,000 ...	2–16*d.*	22,500–25,000....	9–16*d.*
9,000–11,000....	3–16*d.*	25,000–27,500....	10–16*d.*
11,000–13,000....	4–16*d.*	27,500–30,000....	11–16*d.*
13,000–15,000....	5–16*d.*	30,000–35,000....	12–16*d.*
15,000–17,000....	6–16*d.*	35,000–40,000....	13–16*d.*
17,000–20,000...	7–16*d.*		

At a valuation of £40,000 the rate was 8 shillings per £100 or two-thirds of one per cent. For every £1,000 additional value the rate increased one-fifth of a shilling until at £200,000 the rate equalled two per cent.

The revenue from the land taxes was as follows:

YEAR	ORDINARY LAND TAX	GRADUATED TAX	ABSENTEE'S TAX	TOTAL LAND TAXES	PER CENT OF TOTAL REVENUE
1906–7	£317,176	£125,929	£4,237	£447,342	10.49
1907–8	346,166	186,000	5,680	537,846	10.58
1908–9	389,844	209,248	5,809	604,901	13.82
1909–10	417,668	220,044	4,558	642,270	15.13
1910–11	416,426	209,493	2,804	628,723	13.00

reverted to the original rates of 1896.[1] Again, in New South Wales, after the passage of the Local Government Act of 1906 the operation of the land taxes was to be suspended whenever the shire or municipality should levy a similar local rate of not less than one penny on the pound. As such local rates are now levied almost everywhere in New South Wales, the revenue from the state tax has virtually disappeared.[2] Finally, in Western Australia where the tax was introduced in 1907, the rate is only one penny in the pound on unimproved land over £50 in value, with a rebate of one-half the tax to the owner of improved land.

The year 1910, however, witnessed not only the extension of the land-value tax system to Tasmania and its increase in Victoria, but also the adoption of the scheme by the Commonwealth proper. In the same year there was likewise, as we have seen, a decided steepening of the grade in New Zealand.

In Victoria, although the law of 1910 imposes a rate of only one halfpenny in the pound on all land whose unimproved value exceeds £250,[3] the absolute restriction on the valuation of land to £4 as provided by the law of 1890 has been abolished, thus bringing about a substantial increase in the taxes on more valuable property. In Tasmania an act of 1910 levies a progressive tax on land values ranging from one penny to twopence halfpenny in the pound.[4]

Most important, however, was the adoption of a federal

[1] In 1903 the land tax was fixed at three farthings in the pound, the additional tax on rental values over £5,000 remaining at one halfpenny. In 1905 the rates in both cases were made three farthings; in 1906, however, both were reduced to one halfpenny. See p. 115 of the *Blue Book* cited above on page 516.

[2] Between 1902 and 1907 the revenue varied from £300,000 to £350,000 a year. By 1920 the revenue was only £2,834. *Cf.* the *Official Yearbook of New South Wales*, 1909–1910, by John B. Trivett, government statistician, Sydney, 1911, p. 336.

[3] As the unimproved value rises above £250 the exemption diminishes at the rate of £1 for every £1 of excess, so as to leave no exemption at all when the land is worth £500.

[4]

UNIMPROVED VALUE	RATE (PER POUND)	UNIMPROVED VALUE	RATE (PER POUND)
Under £ 2,500	1*d.*	£30,000– 50,000	2*d.*
2,500– 5,000	1¼*d.*	50,000– 80,000	2¼*d.*
5,000– 15,000	1½*d.*	80,000 and over	2½*d.*
15,000–30,000	1¾*d.*		

tax on land values by the Commonwealth in 1910 on the lines of the New Zealand scheme. The rate of this federal tax varied from 1*d*. to 6*d*. in the £ for residents, and from 1*d*. to 7*d*. for absentees.[1] In 1914 the maximum rates were increased to 9*d*. and 10*d*. respectively, and in 1917 to 10½*d*. and 14*d*. respectively.

Although the tax was imposed largely for fiscal purposes, social considerations were by no means lacking. From the fiscal point of view the tax still forms a relatively insignificant feature in the federal budget, the yield in 1911 being about £1,370,000 as against over fifteen millions from other sources, chiefly excise and postal revenue. So far as the burden on the landowners is concerned, however, there must be added to this federal tax the state taxes on land.[2]

Bearing this in mind it may be said that the scale in Australia is now higher than in New Zealand. In both cases the social results may be expected to be more appreciable in the future, especially so far as the largest estates are concerned. Two and one-half to three per cent on land values is equivalent

[1] The exact scales are as follows:

RESIDENTS		ABSENTEES	
VALUES	RATE (PER POUND)	VALUES	RATE (PER POUND)
Up to £ 5,000	exempt	Up to £ 5,000	1*d*.
5,000– 15,000	1*d*.	£ 5,000– 20,000	2*d*.
15,000– 30,000	2*d*.	20,000– 35,000	3*d*.
30,000– 45,000	3*d*.	35,000– 50,000	4*d*.
45,000– 60,000	4*d*.	50,000– 65,000	5d.
60,000– 75,000	5*d*.	65,000– 80,000	6*d*.
over 75,000	6*d*.	over 80,000	7*d*.

[2] The yield of the land tax in the Australian states for the past few years is as follows:

	1905–06	1907–08	1909–10
New South Wales	£336,785	£178,889	£ 9,066
Victoria	103,536	89,496	114,357
South Australia	94,601	93,762	94,126
Western Australia		11,140	34,344
Tasmania	54,776	57,742	79,021
Total	£589,698	£431,029	£330,914

Cf. The Official Yearbook of the Commonwealth of Australia of 1901–1910, No. 4, Melbourne, 1911, p. 840.

to fifty per cent on the income—an obviously prohibitory tax. Whether the tax will turn out to be destructive of large holdings will depend chiefly on the general conditions of prosperity and on the rise in the value of the land. If land values rise faster than the amount of the tax, the influence of the law will continue to be slight. To the extent, however, that there may be a slackening in the rise of land values, the effect of the tax will soon be apparent.

VI. *The Exemption of Improvements in Australasia*

The second point of interest in the Australasian development is that the principle of land-value taxation, first applied in the states, has been extended not only to federal, but also to local taxation. It is true indeed that the form which the local movement has taken has been slightly different from that of the state and federal movements. The local taxes or rates, as they are called, were originally levied largely on the same principle as in the mother country; that is, the rates were imposed on the rental value or the so-called annual value of real estate. The practical consequence was the same: when the property was not rented it was assumed to possess no rental value and it therefore paid no taxes. Under this system, vacant land might be held out of the market for speculative purposes for an indefinite time. To prevent this practice, a movement set in to replace the tax on rental values by one on capital values. In some cases a further step was taken: improvements were exempted in whole or in part, so that the tax, to an increasing extent, now fell upon bare land values.

It is true that in the majority of the Australasian states this new system has not yet been introduced. Thus Victoria, South Australia, West Australia and Tasmania still levy the rates on annual value. But in the three other states, namely, in New South Wales, Queensland and New Zealand, the new system has been applied. In Queensland the law dates back as far as 1890; in New Zealand to 1896, and in New South Wales to 1906, although in each case the system was actually inaugurated a few years later.

In Queensland the Valuation and Rating Act of 1890 was passed chiefly for fiscal reasons. The movement goes back to a law of 1879 known as the Divisional Boards Act.[1] While this

[1] For the history of these earlier attempts, *cf*. p. 197 *et seq*. of the *Blue Book* mentioned above, on page 516.

bill was under discussion it was suggested that as considerable areas of country were in process of purchase from the crown, under the condition that certain improvements be made, the obligatory improvements ought to be exempt for rating purposes, as otherwise the conditional purchasers might delay making them. The purpose of this suggestion was obviously to accelerate the settlement of the country. The further suggestion that the concession for improvements ought to be extended to the towns was stoutly opposed, and in the case of country lands the endeavor to exempt improvements other than houses and buildings was defeated. The law as passed, provided that in the case of ratable property in the country districts, there should be a separate valuation of land and of houses, and that there should be deducted from the total annual rental value "an amount equal to one-half that portion of such rent as shall be deemed to arise from any buildings that may be situated on such ratable property."

This remained the situation until 1887 when the Valuation Act provided that in the case of town and suburban lands the annual rental subject to taxation should be estimated as a sum equal to two-thirds of the rental value, including improvements. A further modification was introduced in fixing the tax limit. In the case of unimproved land the minimum fixed for the rate of taxation was a little higher than upon improved land (eight instead of five per cent upon the fair capital value), and where the land was "fully" improved, no minimum at all was insisted upon. Furthermore, it was provided that county lands should be estimated at the fair average value of unimproved land of the same quality in the same neighborhood, the annual value to be taken at a certain percentage of this capital value. Thus improvements were taxed more lightly than land in the towns, and were completely exempted in the country districts.

In 1890 the general finances of Queensland caused grave concern, and after the failure of an effort to levy an additional tax upon property of all descriptions, the Valuation and Rating Bill was so framed as to give the local authorities greater taxing powers. Hitherto the state government had given £2 for every £1 raised locally by the divisional boards. In the course of the discussion the proposition was made not only to change the system of local rating from rental to capital value, but also to provide for a total exemption of all improvements. Public attention, however, was more strongly directed to the need of increasing local taxation than to the particular method of rating.

In the years following the adoption of this new system the valuation of land fell off very greatly, necessitating, of course, a progressively increasing rate of tax. Up to 1893 the decrease in the valuations may be ascribed to the law. After 1893, however, it must be in part ascribed to the commercial crisis of 1893, from which Australia did not recover until the beginning of the new century.[1] In the larger towns this situation caused no little anxiety and led to the appointment of a royal commission in 1896. While the report of the commission was on the whole favorable to the new system, it must be remembered that the comparison was between the new system of taxing the capital value of land and the old one of taxing the rental value of all real estate. The law of 1890 had still included the valuation of buildings in the case of occupied crown lots on mineral fields, owing to the difference in the marketable capital value of the land as compared with other lands. But in 1902 the Local Authorities Act extended the principle of the exemption of improvements for local rates to all lands.

The next state to adopt the system was New Zealand. In 1896 an Optional Rating Act was passed, giving the local bodies the option of choosing between the ordinary rating system, according to annual value, and a new tax on the unimproved capital value of land. The law, still in force, provides that a shilling in the pound on the annual value shall be deemed to be equivalent to three farthings in the pound on the capital value of any ratable property; or that the annual value of any ratable property should be deemed equal to six per cent of its capital value. The rates on the unimproved value of the land must "be so adjusted as to equal as nearly as may be, but not to exceed, in producing capacity, the rates made and levied on the annual or capital value as the case may be" under the old law. The annual value is deemed to be the letting value less twenty per cent in the case of houses, buildings and other perishable property, and

[1] As an example of this change we append the valuation figures for the city of Brisbane, as found on p. 202, the *Blue Book* cited above:

	VALUATION
1890, under the old system	£9,061,450
1891, under the new system	8,800,351
1892 " " " "	7,814,185
1893 " " " "	6,745,553
1894 " " " "	6,363,308
1895 " " " "	5,807,541
1902 " " " "	5,882,055

less ten per cent in the case of land; but in no case shall the annual value be deemed to be less than five per cent of the value of the fee simple. The capital value is deemed to be the selling value of the land including improvements. The maximum limit of the tax, so far as the general rate is concerned, is fixed at 2*s.* in the pound on the annual value or at 1½*d.* in the pound on the capital value of all ratable property, or its equivalent on the unimproved value.[1]

The law provides that the petition to change to the new system must be signed by at least fifteen per cent of the rate payers, and that it must be adopted by a majority vote. In 1899 the first locality made use of this provision, and during the next few years the system gradually spread. By 1906 seventy-five localities had decided to take a vote on the change and out of these seventy-five, sixty-three voted "yes" and twelve voted "no." A few years later, in 1909-10, out of 159 boroughs in New Zealand, 43 levied the local rates on the unimproved value of land, 18 on the capital value of real estate and 40 according to the old system of annual value.[2]

As the boroughs are naturally the most prosperous parts of the counties, the importance of the unimproved value system is really somewhat greater than would appear from the above figures. As a matter of fact, almost one-third of all the rates were collected under the new system.[3] Of the four largest cities two, Wellington and Christ Church, have adopted the system of exemption of improvements, but the other two, Auckland and Dunedin have refused it. In considering the above figures, moreover, two points must be remembered: first that as the old system was supplanted the new one of basing the rates on capital

[1] *New Zealand Official Yearbook for 1911*, Wellington, 1911, p. 169.

[2] The figures for the different local divisions are as follows:

	TOTAL REPORTING	RATES ON RENTAL VALUE	RATES ON CAPITAL VALUE	RATES ON UNIMPROVED VALUE
Counties	346	6	286	54
Boroughs	109	48	18	43
Independent town boroughs	23	2	17	4
Total	478	156	321	101

[3] Full details for each locality will be found in the *New Zealand Official Yearbook*, 1911, pp. 178 to 192, inclusive.

or selling value was chosen by five times as many counties and about half as many boroughs as those that selected the method of exemption of improvements; and secondly that the system of rating on the unimproved value of land applies only to the so-called general rate, and not to the special rates levied for water, gas, electric light, sewage, hospital or poor relief purposes.

In New South Wales the system was inaugurated almost a decade later. In 1905 the so-called Shires Act was passed which, as supplemented by the Local Government Extension Act of the following year, provided that the general local rates should thereafter be levied on the unimproved value of the land at a rate of not less than 1*d.* nor more than 2*d.* in the pound. A council of a municipality which has levied a rate of not less than 1*d.* on the unimproved value is permitted to impose such additional rate as may be required on either the improved or the unimproved value. The total amount, however, to be derived from these general rates, taken together, is required not to exceed the amount yielded by a rate of 2*d.* in the pound (0.83 per cent) on the unimproved value, or 1*s.* 6*d.* in the pound (7.5 per cent) on the assessed annual value of all ratable land.[1] It is also provided that as soon as any locality puts this new system into force the operation of the state tax on land values is to be suspended.[2] Here, again, it is to be noted that in addition to the general rates, the so-called special rates, as well as local and loan rates may be imposed on either the improved or the unimproved value. Most of the municipalities have, however, chosen to levy these extra rates on unimproved value. An important exception consists of the rates imposed by certain water-supply and sewerage boards which are still levied according to the old system. In 1912, sixty-four out of seventy-three municipal and shire councils raised £399,197 on land values of £31,344,898,[3] the average rate for all local taxes being 1.27% of the value of the land. It will be seen how low the rate of taxation is, as compared with American conditions.

Finally, it may be added that in South Australia the Land Values Assessment Act has for some time permitted the localities to substitute for the existing local rates, which may be

[1] *Official Yearbook of the Commonwealth of Australia, 1901–1910*, Melbourne, 1911, p. 985.

[2] *Cf. supra*, p. 520.

[3] The figures are printed in detail in the Sydney *Standard*, and reprinted in the March, 1912, issue of the Melbourne *Progress*.

levied either on gross annual rental or on capital value, a new system of taxes on the unimproved value of land. No locality, however, has yet availed itself of this permission.

Such has been the development of the law. What are the practical results? It is usually claimed by the advocates of the system that the exemption of improvements will do away with speculation, stimulate the building trade, lower house rentals and abolish congestion of population in the cities. What light does the Australasian experience throw upon these claims?

In considering this problem we are dependent for information largely upon the reports of the local authorities. In a few cases we have some information as to the local results of the state taxes on land values; but these taxes, it will be remembered, are so insignificant as to be almost devoid of importance in the towns. Thus in South Australia, where after 1895 considerable areas of suburban land in the towns were built upon, we are told, in an official report of 1906, that "much of the improvement would have occurred irrespective of taxation, with the gradual growth and advancement of the state." [1] Furthermore, we are informed that "on the rental of house property and vacant sites, the effect is not appreciable." Finally we are told that while there was a falling off in speculation, this was due entirely to the collapse of the land boom in the eighties, for "this phase of speculation is in no wise affected by taxation.[2]

Similar testimony comes from New South Wales. The acting statistician of that state tells us that the effect of the state tax on land values has been inappreciable. Suburban building has indeed considerably advanced, "but there is no doubt that much of the extension is due to the facilities for settling in the suburbs afforded by the excellent tramway system." [3] Rentals in the suburbs have indeed fallen, but "the reduction is due but slightly to the operation of the land tax, the chief cause being the opening up of newer and more select localities through the extension of the metropolitan tramway and railway system." He adds: "as regards the suburbs beyond the influence of the tramway system, experience shows

[1] "Papers relative to the Working of Taxation of the Unimproved Value of Land in New Zealand, New South Wales and South Australia," in the *Blue Book* mentioned above. See especially p. 115.

[2] *Ibid*, p. 116.

[3] *Ibid*, p. 132.

that in general there has not been any material alteration in rents for ordinary tenements." The entire situation is summed up in these words: "On the whole it may be said that the land tax has had no very appreciable effect on any of the conditions referred to," that is, the building trade, rentals, vacant sites or land speculation. This conclusion is concurred in by the First Commissioner of Taxation who says that: "taking the operation of the land tax as a whole, it is not considered that it has had any pronounced effects on the land generally," so far as the towns are concerned.[1]

The effect of the state taxes on land value accordingly, was unimportant. As to the effect of the exemption of improvements in local taxation, the existing information is limited to New Zealand and Queensland. In New Zealand the commissioner of taxes sent a circular addressed to all the local authorities: fifty-two replies were received, of which a digest has been printed. While not a little testimony unfavorable to the new system was elicited, most of the localities declare it satisfactory. During the period of its operation there was a general increase of prosperity throughout the state. In some of the replies, however, doubt is expressed whether this prosperity was in any way due to the method of taxation. The great majority of the replies are to the effect that no especial results can be discerned either one way or the other. Thus the Eketahuna council writes: "unable to say what effect is, as success of the dairying industry overshadows the effect of taxation." The Hokitika council writes that many new buildings "have recently been erected, but this is attributed to prosperity rather than change in rating." The Hawera council tells us that the "building trade, rent, land speculation, *etc.*, have not been affected to any appreciable extent." The Pahiatua council writes that the briskness in the building trade "is considered due to natural causes," and to the general prosperity of the community.

Again, so far as the influence of taxation on rents is concerned, while some localities think that rentals have been reduced, others state the contrary. Thus, Grey Lynn tells us that the system "does not affect building trade, and has not tended to reduce rents." The Kairanga council says: "Building trade not stimulated; rents little affected." From Karori borough we hear: "do not think building trade or rents affected." From Maraetai we learn: "no perceptible change in buildings

[1] Blue Book, *op. cit.*, p. 133.

or otherwise." The North East Valley borough states: "does not materially reduce rents." Finally, Woolston borough informs us that while the building trade is improving "rentals are not lower." Some localities in fact go still further and call attention to the inevitable results of the system. Thus, the Stratford borough council holds that the "system acts unfairly and tends to the crowding of houses on small sections," and from Winton borough we hear that the system "throws tax much heavier on unimproved sections and appears to benefit those who crowd good buildings on small areas."[1] The testimony from New Zealand thus appears to be inconclusive and something at least can be said on both sides of the question.

When we come to Queensland we find a very able report from Mr. Corrie, a leading architect who has served for many years as a valuer in Brisbane. While he is favorable on the whole to the exemption of improvements, he tells us that the objection that the system must lead to the over-utilization of the land "has not so far been tested in the state."[2] Moreover, he is decidedly of the opinion that while the system has hitherto worked fairly well, there are distinct limits to its usefulness and even to its possibility. He writes:

> "Although raising considerable local revenues on unimproved land value has so far met with little objection, it by no means follows that very profound study has been accorded to the subject by those most interested.[3] . . . As further duties come under local government jurisdiction, the present system cannot escape from very critical examination, for manifestly there is a limit to the burden which will be accepted upon any single class of property."

He tells us that since the local taxes on land values are at present not excessive and are expended upon services from which the land derives a reasonable benefit, there is not much likelihood of discontent soon arising from the system in Queensland. But he points out that as soon as the land tax increases to the point of diminishing the capital value of the land, discontent will be sure to arise. What has saved the system thus far has been the low rate, coupled with the rise of land values due to the general prosperity of the colony. He adds:

> "As taxes increase, however, and especially as fresh duties have to be undertaken, all the issues will be less simple, and other forms of

[1] *Op. cit.*, pp. 138–140. [2] *Ibid.*, p. 211. [3] *Ibid.*, p. 212.

property—as, for instance, in the fight over the Brisbane hotels question—will be looked to for contribution as well as land."

His conclusion is that the future has in store the "due recognition of two important factors in municipal finance (not satisfactorily accounted for under a land tax)—*viz.*, 'ability to pay'—and the now equally recognized principle that 'persons as well as things' should contribute." [1]

From this Australasian evidence three inferences can be drawn: In the first place, so far as the testimony is favorable to the exemption of improvements, it must be remembered that the new system is compared with the old method of taxing rents. What pleases the public, so far as they are pleased, is not so much the exemption of improvements as the change from taxation of rentals to taxation of capital value. This is apparent from the testimony. Thus, for instance, the Wellington city council favors the new method chiefly because it "paralyzes the old system under which rental values on lands could by simple manipulation reduce local taxation to a farce." [2] In this connection it is a most significant (although hitherto unnoted) fact that in South Australia, where the exemption of improvements is legally permissible and where no locality has yet availed itself of the permission, the old system of local rates allows an assessment on capital values. That is to say: where local rates are levied only on rental values, there arise all the difficulties which have induced England and Germany to impose new land taxes, and which have led in Australasia to the exemption of improvements; but where the tax is levied on capital instead of rental values, as is the case in the United States and as is true

[1] These inferences are corroborated by the results of an independent investigation subsequently made by J. E. Le Rossignol of Denver and W. D. Stewart of Dunedin in an article entitled "Rating of Unimproved Values in New Zealand," and published in *Addresses and Proceedings of the First Conference of the National Tax Association*, New York, 1908, p. 273 *et seq.* After pointing out that in cities like Wellington, overcrowding has been increased rather than diminished, and that taxes on rural property in general have been relatively increased as compared with taxes on town property, the authors tell us that "the facts do not warrant optimistic conclusions. . . . The benefits of rating on improved value are not so obvious as to command unanimous approval. . . . The opposition to the system appears to be growing stronger as the people are coming to recognize its relation to the propaganda for single tax. . . . Up to the present time the economic effects of rating on unimproved value have been insignificant." See esp. p. 284.

[2] *Ibid.*, p. 140.

in large measure in South Australia, the tendency to any change is far less apparent. So far, therefore, as the results of the Australasian system of exempting improvements from taxation are deemed favorable, they may be declared to be due primarily to the adoption of the system of taxing capital instead of rental values.

In the second place, even thus limited, the reports of the experiments in Australasia are inconclusive. In some cases we hear of good, in other cases of bad results. Nowhere has a careful study been made of the consequences of the exemption of improvements as compared with a tax on the capital value of all real estate. Finally, as the experience of Queensland clearly shows, the whole system is of slight importance partly because the rates have been low, and partly because the adoption of the new method of assessment has come at about the same time as the recovery from the long depression of the early nineties.

When to all these considerations we add the fact that in most cases only a portion of the local rates are levied on land values, we are forced to the conclusion that a much longer experience will be required before it can be asserted with any reasonable degree of confidence that the system of exempting improvements from taxation has had results at all comparable to those that are often ascribed to it by hasty writers.

VII. *The Australian Income Tax and the Relation of State to Federal Finance*

The third phase of tax reform in Australasia mentioned above [1] is the development of the income tax. Here again we have to deal not with the sudden introduction of any new principle, but with the elaboration of a system initiated some time ago. The last few years have everywhere witnessed a growing realization of the importance of income taxation, and in several states the year 1910 marked a significant change.

Australasia was among the earliest democracies to introduce progressive inheritance taxes. These have remained substantially unchanged for several decades. Income taxes came considerably later. With the exception of South Australia where such a tax was introduced in 1884 there were no income taxes on the Australian continent until shortly

[1] P. 516.

before the end of the nineteenth century. New Zealand followed in 1891 when an attempt was made to reach incomes by the same act which imposed the land tax. The income tax was only slightly progressive: 6*d.* in the pound on the first taxable £1,000, and 1*d.* on each additional £1,000. It was not until 1895 that Victoria and New South Wales introduced the income tax, and not until 1902 that Queensland and Tasmania followed suit.[1] In the year 1907, however, there began a new phase of income taxation: such taxes were introduced where they had not yet existed, and almost everywhere the old taxes were increased both in amount and in the steepness of the scale of progression. Thus in 1907 the income tax system was extended to Western Australia and the earlier laws of Queensland and New South Wales were amended; and in 1910 the rates in Victoria, Tasmania and New Zealand were increased, in some cases to a substantial extent. Finally the Great War not only led to considerably higher rates in all the Australian states but brought about in 1915, the introduction of a federal income tax with an elaborate scale running up to 25 per cent. The details will be found in the note.[2]

[1] In Seligman, *Progressive Taxation in Theory and Practice*, 2d ed., 1908, p. 97 *et seq.*, will be found a detailed account of all the income taxes which were in force in Australasia up to 1906, with the single exception of New South Wales, where the income tax was not levied according to the progressive principle. In New South Wales the law of 1895 imposed a tax of 6*d.* in the pound on all incomes of £200 and over, if not derived from land.

[2] *Victoria.* The law of 1895 provided for a progressive scale which was changed in 1903 and 1904. In the case of incomes from personal exertion, the rate (1912) was:

INCOMES	RATES (PER £)	INCOMES	RATES (PER £)
£100 to £ 500	3*d.*	£1,000 to £1,500	5*d.*
500 " 1,000	4*d.*	over 1,500	6*d.*

If the income was derived from property, the rates were doubled. In 1906 incomes under £200 were exempted, and an abatement of £150 was allowed on incomes from £200 to £500. In 1908 a distinction was made between individual and corporate incomes, the former being reduced by 20 per cent; but in 1910 this was repealed. Land used as a residence by the owner was deemed to yield an income of four per cent on its capital value. A tax of 7*d.* in the pound was imposed on the incomes of all corporations except life insurance companies, which pay at the rate of 8*d.* in the pound. Foreign ship owners pay 5*d.* in the pound.

New South Wales. The act of 1895 was amended in 1907; the rate was still 6*d.* in the pound, but in the case of incomes derived from personal exertion the exemption was increased to £1,000. Further amendments

From the point of view of revenue the income taxes play a considerably greater rôle than the land taxes. In New South Wales and Victoria, even before the war, they were exceeded in

were made in 1911 and 1914. In 1919 the rates varied from 8*d.* in the pound on incomes up to £700 to 1*s.* 2*d.* on incomes over £9,700, with an addition of one-third on incomes from property. The exemption is £250, plus £50 for insurance and superannuation premiums, and there is a deduction of £50 for each child. For companies the rate is 1*s.* in the pound.

Queensland. The act of 1902 was amended in 1906 and 1907 as follows:

INCOMES FROM PERSONAL EXERTION	RATES (PER £)
£ 200–£ 500	6*d.*
500– 1,000	6*d.* up to £ 500; 7*d.* above
1,000– 1,500	7*d.* up to £1,000; 8*d.* above
over 1,500	8*d.*

£200 was deducted in every case. On incomes derived from property the rate was 9*d.* in the pound, and in the case of absentees and corporations, the rate was 1*s.* in the pound.

South Australia. The act of 1884 has been frequently amended. The rate in the case of incomes from personal exertion was in 1912 four pence halfpenny in the pound for all incomes from £150 to £800 and 7*d.* in the pound above £800. In the case of income from property the rates were 9*d.* and 1*s.* 1½*d.* respectively. In the case of incomes up to £400, £200 were exempt.

Western Australia. The law of 1907 fixed a rate of 4*d.* in the pound on all incomes over £200; and fifty per cent additional in the case of absentees. Corporations, however, were, by a law of 1899, as amended in 1906, subject to a tax of 1*s.* in the pound on dividends.

Tasmania. The act of 1902 was repealed in 1910, when the following rates were imposed in the case of incomes from personal exertion:

INCOME	RATE (PER £)	INCOME	RATE (PER £)
£125	4*d.*		
125–£150	4¼*d.*	£900–£1,000	6*d.* on first £400
150– 250	4¾*d.*		7*d.* on next £200
250– 350	5½*d.*		8*d.* on next £200
350– 400	5¾*d.*		10*d.* on remainder
400– 700	6*d.* on first £400	Above £1,000	Same rates on first £800
	7*d.* on remainder		10*d.* on next £200
700– 900	6*d.* on first £400		1*s.* on next £500
	7*d.* on next £200		1*s.* 2*d.* on next £500
	8*d.* on remainder		1*s.* 4*d.* on remainder

In the case of incomes from property, the rate was 1*s.* in the pound, provided that the income was over £100. Incomes under £80 in the case of unmarried persons or under £100 in the case of married persons were exempted. The following abatements were permitted:

INCOME	EXEMPTION	INCOME	EXEMPTION
£ 80–£110	£70	£150–£250	£40
110– 125	60	250– 350	30
125– 150	50	350– 400	20

importance only by the inheritance taxes. In Queensland and South Australia the income tax was the most important, in Western Australia the dividend tax. It is only in Tasmania

Every taxpayer, the taxable amount of whose income was less than £150 could claim a rebate of 2*s.* 6*d.* for every child under 16 years.

In addition to the income tax the law of 1904, amended in 1906, imposed a so-called ability tax, the amount of which was determined according to the annual value of the property occupied, or the amount paid for board and lodging. In the case of property the rate varied from 1*d.* to 6*d.* in the pound, on the annual value. In the case of board and lodging the rate varied from 3½*d.* to 6*d.* in the pound on the amount payable annually for board and lodging.

New Zealand. The law of 1891 was amended in 1910 as follows: A deduction was allowed for £300 of income. Up to £700 the rate was 6*d.* in the pound, rising gradually until in the case of incomes exceeding £2,300 the rate was 1*s.* 2*d.* in the pound. In the case of corporations there were no exemptions and the rate varied from 1*s.* to 1*s.* 2*d.* in the pound.

In 1915 the tax was increased one-third. In 1916 an extra 6*d.* was added up to £900, and 1*s.* 1*d.* over £900. In 1917 a special war tax of 4*s.* 6*d.* was imposed, which, added to the 3*s.* regular tax, made a maximum of 7*s.* 6*d.* A deduction of £300 was allowed when the total income did not exceed £600; and between £600 and £900, the deduction of £300 was reduced by £1 for every £1 of income above £600. £25 were also allowed for each child under sixteen years of age.

The Commonwealth. In the law of 1915, on incomes derived from personal exertions the rate is 3 3/800*d.* per pound, increasing by 3/800*d.* with each increase of one pound of the taxable income until an average rate of 2*s.* 7½*d.* per £ is reached on £7,600. Over that sum the rate is 5*s.* in the £. On income derived from property the rate up to £546 is stated by the following formula:

$$R=\left(3+\frac{I}{181.058}\right)d.$$

R= rate.
I= taxable income.

On sums between £546 and £2,000 the tax increases continuously until it reaches 33.6*d.* per £ on £2,000 10*s.*, and thence rises to a rate of 5*s.* per £ for every £ in excess of £6,500. An additional tax is levied of 25% as well as a supertax of 30% of the total amount of the tax. The exemption is in the case of unmarried taxpayers with no dependents £100, less £1 for every £5 in excess of £100. In the case of married taxpayers, or those with dependents, the exemption is £150 less £1 for every £3 in excess of 150. The deductions are £26 for every child under sixteen; £50 for friendly society and superannuation premiums; another £50 for life assurance and fidelity guarantee premiums; and all gifts over £5 to public charitable institutions or war relief funds. Winners of prizes in lotteries pay 13%. Absentees are taxed on their income received in Australia. Companies pay 8d. in the £ on dividends and interest to absentees and 2*s.* 6*d* in a £ on all taxable income not distributed.

and New Zealand that the land tax yielded more than the income tax. Since the war even this is no longer true.

In Australasia, as a whole, if we take the income and the inheritance taxes together we find that their yield forms an overwhelming proportion of the revenue from direct taxation. Entirely apart from any consideration of the indirect taxes which are still so important, Australasia may be said to be moving away from, rather than in the direction of, the principles of the single tax.[1]

One feature in the development of the taxation of incomes by the states deserves a word of mention in view of the controversy over the general subject in the United States. Originally much difficulty was experienced in making the salaries of federal officials subject to income taxation. In 1907, however, the federal Parliament enacted the Commonwealth Salaries Act which declared that salaries and allowances paid by the commonwealth are liable to taxation by the states. The only exemption is the salary of the governor-general.

The fourth and final point in our consideration of tax reform in Australasia is the relation of state and federal finance. When the commonwealth was created in 1900, the constitution vested in the federal government exclusive power of levying customs and excise duties and in the state and the federal governments concurrent powers of direct taxation. But as the revenues of the various states had previously been derived largely from customs and excises, and as it was practically certain that the commonwealth expenditures would, for some years at least, not equal the revenue derived from these sources, it was decided to allot to the states a certain proportion of this revenue. In default of such allotments the states would have found it necessary to raise the rates of the taxes on inheritances, incomes and land to inordinate heights. It was accordingly provided in the so-called "Braddon" section of the act by which the federal constitution was established, that during the first ten years of the newly created union, and thereafter until otherwise decided, there should be returned to the states three-fourths of the net revenue from customs and excises. Thus was adopted the system of the collection of taxes by the central government, with the distribution of a part of the proceeds among the states.

[1] A convenient summary of existing laws is *Income Taxes in the British Dominions.* Compiled in the Internal Revenue Department, London, 1923; with an *Appendix*, 1924.

The Braddon clause was, however, not the only section affecting the relations of federal and state government. Many functions of government, which under the American system are reserved to the states, were transferred from the states to the commonwealth. It was fully recognized that the discharge of these functions would necessitate large federal expenditure; but it was not believed that this transfer of expenditure would be, at first at least, at all commensurate with the transfer of revenue. Consequently there was inserted in the constitution a provision for the repayment to the states of any surplus federal revenue. The principles which should govern the allocation of revenues according to this clause, as well as under the Braddon clause, were set forth in a special section of the constitution, which was to remain in force for five years and thereafter, until changed by Parliament. This embodied what became known as "the bookkeeping system." Under this scheme each state was to be credited with the federal revenue collected in respect of that state, and to be debited with the expenditure incurred on its behalf in connection with the transferred departments as well as with its share, on a *per capita* basis, of the new expenditure of the commonwealth. It was also provided that the duties chargeable on goods imported into one state and consumed in another should be credited to the consuming state, on the theory that the duty ultimately falls upon the consumer. The balance in favor of any state is payable monthly by the commonwealth.

Finally, another special clause (section 96) of the constitution provided that the Commonwealth parliament might grant financial assistance to any state on such terms and conditions as the parliament should think fit. This section was introduced with the object of rendering the constitution more elastic in the matter of assistance to the states than it would have been if the Braddon clause and the bookkeeping system were rigidly adhered to. No claim for such special assistance has, however, yet been made.

So far as the Braddon clause is concerned, it may be said that for some time it worked fairly well, although with every year the situation became more embarrassing in the separate states, for the reason that, in making up their budgets, it was practically impossible to forecast for the immediate future what would be the share of each state in any particular federal tax. Moreover, the one-fourth revenue assigned to the federal gov-

ernment gradually proved to be inadequate for its expenses. At first the commonwealth returned to each state not only the three-fourths due it, but a substantial balance in addition. By 1908, however, not only had the growing expenses of the commonwealth swallowed up the whole of the one-fourth, so that there was no balance to be returned to the states, but the one-fourth itself was now inadequate.[1]

This contingency was foreseen several years before it arose and attempts were made to find some satisfactory way out of the difficulty. Repeated conferences were held by the premiers of the several states, but it was not until 1909 that an agreement was reached. Meanwhile the matter had become particularly urgent, because of the decision that the federal government should assume all the state debts. The agreement between the ministers of the commonwealth and of the states was to the effect that the commonwealth should retain all of the customs and excise revenues, and that it should pay over to the states a definite sum every month, computed at the rate of £1 5s. per annum per head of population. In view, however, of the heavy obligations incurred by the commonwealth in the payment of old-age pensions, provision was made for withholding from the actual shortage in the revenue the sums returnable to the states during that year, with an adjustment as between the pension states and the non-pension states. Finally, because of the large *per capita* contribution of Western Australia to the customs revenue, there was granted to that state an additional special annual payment: this was to be £250,000 the first year and was to diminish by £10,000 annually thereafter. One-half of this allotment to Western Australia was to be deducted from the shares of the other states.

[1] This is apparent from the following figures:

YEAR	NET REVENUE CUSTOMS AND EXCISES	ONE-FOURTH ASSIGNED TO COMMONWEALTH	NEEDED FOR COMMONWEALTH EXPENDITURE	BALANCE RETURNED TO STATES
	£	£	£	£
1901–02	8,633,996	2,158,499	1,269,757	888,742
1902–03	9,413,442	2,353,110	1,207,876	1,145,234
1903–04	8,844,195	2,211,049	1,465,716	745,333
1904–05	8,543,310	2,135,827	1,400,541	735,286
1905–06	8,739,298	2,184,825	1,354,915	829,910
1906–07	9,386,097	2,346,524	1,540,523	806,001
1907–08	11,368,220	2,842,055	2,511,315	330,740
1908–09	10,573,860	2,643,465	2,643,465	*nil*
1909–10	11,323,207	2,830,801	2,830,801	*nil*

The act embodying this agreement was passed in December, 1909, to take effect as an amendment to the constitution; but the amendment was rejected by the electors at a referendum in April, 1910. It therefore devolved on the federal parliament to settle the question by law, and a few months later the Surplus Revenue Act was passed, which embodied practically the same provisions, and which is now in force.[1] By the terms of this act the commonwealth undertook during the period of ten years commencing July 1, 1910, and thereafter until parliament should otherwise provide, to pay to each state, or to apply to the payment of interest on the state debts assumed by the commonwealth, an annual sum of 25*s.* *per capita*. The state of Western Australia was to receive an additional sum amounting in the first year to £250,000 and diminishing in each succeeding year by £10,000 and one-half of these payments was to be deducted proportionately from the amount payable to all the states. Any surplus revenue in the federal treasury at the end of any year was to be turned over to the several states, and for the year 1911 the commonwealth was authorized to deduct from the amount payable to the states, the estimated deficit in the federal budget, figured at £450,000. In the same federal election in which the fiscal amendment to the constitution was rejected, the provision to have the commonwealth assume all the debts incurred by the states was adopted.

VIII. *Conclusion*

The foregoing survey of the tax reforms in England, Germany and Australasia appears to justify certain general conclusions:

First and foremost, attention is to be directed to the great development of the income and inheritance taxes, with the adoption of the modern principles of progression and of differentiation of taxation. In this respect, as we have seen, England has taken the lead, although Germany follows closely in the income tax, and Australasia in the inheritance tax. In Germany the effort to round out the system of direct taxes by the inheritance tax has thus far been only partially successful; while in Australasia, where the inheritance taxes were the first to be adopted, the income tax is for the most part levied on a scale somewhat similar to that in England. The growth of the taxa-

[1] The act is printed in full in *The Official Year Book of the Commonwealth of Australia, 1901–10*, Melbourne, 1911, p. 800.

tion of incomes and inheritances is the most significant aspect of the endeavor to realize the principle of ability in taxation.

Second in importance is the development of the land taxes and more especially of the taxes on land values. Here, as we have seen, Australasia was really the first in the field, with Germany next and England following closely. But in Australasia the movement has been primarily toward the exemption of improvements from taxation, coupled with a progressive tax on land, for social rather than for fiscal reasons. In Germany, on the other hand, the significant tendency has been in the direction of the taxation of the so-called unearned increment of land, first by the towns, and more recently by the empire. England has gone further than either of the other countries in that it combines with the increment-value duty a tax on so-called undeveloped land.

In none of these cases, however, should the significance of the land taxes be misapprehended. Far from constituting an attempt to apply the principles of the single tax, as is often erroneously asserted, the movement aims rather to realize more fully the principles of ability to pay by emphasizing the production rather than the consumption side of the doctrine of faculty.[1] Not only is the fiscal importance of these land taxes everywhere a minor consideration but, as I have pointed out, the real significance of the state land taxes in England and Germany and of the local land taxes in Australasia is to be found in the endeavor to substitute for the old and discredited method of taxing land according to rental value the newer method of taxing land according to capital or selling value. The old system gave an unjust advantage to the land speculator and was largely responsible for the congestion of population in the towns. The new system is an attempt to make the landowner bear his proper share of the public burdens.

The third point to be emphasized is the importance that is still attached to indirect taxes. In England, as we have seen, the additional revenue that has been provided by the recent tax reforms has come equally from direct and indirect taxes. In Germany far greater stress has been put upon the indirect than upon the direct taxes; and in Australasia the overwhelming mass of the total revenue, federal and state, is still derived from the customs and excises.

These facts indicate not only the fallacy of the claim that there is any tendency toward a single tax on land, but also

[1] *Cf. supra*, p. 341.

the incorrectness of the assertion that the revenue of modern states must be derived chiefly from direct taxes. A careful study of the evidence leads us to the contrary conclusion, and shows that there must be some fundamental explanation of the persistence of indirect taxes. This is not the place to attempt such an explanation—which, it may be said in passing, is not given in any of the current treatises on finance. The outlines at least of such an explanation may be found in the suggestion that direct taxes, based on the principle of faculty or ability to pay, respond to the individual element in the problem of taxation, while indirect taxes, which cannot be explained on any such principle of individual ability, correspond to the no less important social element.[1] Whatever may be thought of this suggestion, and whatever limits it may be necessary to posit in the elaboration of a system of indirect taxes, it is none the less true that no explanation of the existing facts of tax reform will hold if it fails to appreciate the important place that is to be assigned in the future, as well as in the present, to indirect taxes, side by side with the direct taxes.

The fourth conclusion is the increasing importance which is to be attached to a study of the relations between central and local finance, both as between national and state, and as between state and communal finance. Our survey discloses several important tendencies. First to be noted is the provision for new and independent sources of federal revenue, as in Australia with the land tax, and in Germany with the land tax, the inheritance tax and the suggested federal tax on possessions. In the second place, we notice the gradual transfer of state taxes to the federal government, as regards not only the administration, but also the yield. Thus in Australasia the customs and revenue taxes are assigned to the federal government; while in Germany some of the state excises as well as the state inheritance taxes are transferred to the federal government, and the land increment taxes are at least to be controlled by the imperial authorities. In the third place, we observe that the taxes collected by the central government are distributed, in part at all events, among the states and even in some cases among the localities. Not to speak of the English system of grants in aid, we find in Australasia a distribution of surplus revenues among the states and in Germany an apportionment of the inheritance tax as between empire and states and the distribution of the new

[1] *Cf. supra*, chap. ix, p. 324.

land taxes among empire, states and localities. More and more the fiscal problem is being envisaged as a totality, and the relative claims of the community, state and central governments are being considered from the point of view of an equitable distribution of the entire burden resting upon the individual or the class. This is the most recent phase of modern tax reform, and for this reason doubtless it has hitherto received the least study. It is, however, perhaps the most distinctive aspect of the modern movement.

Summing up all these conclusions we see that modern tax reform, as illustrated in these three great nations, presents a combination of social and fiscal considerations; or rather, that an attempt is being made to solve the fiscal problem with due regard to the social aspects of the situation. If it be inquired what lessons these movements contain, so far as the United States is concerned, it would probably not be far amiss to state them as follows:

In the first place, so far as indirect taxation is concerned, the United States has not much to learn from this recent development. Almost the entire revenue of the federal government is derived from indirect taxes, and in some of our leading commonwealths not a little revenue is drawn from similar sources. Taking public revenues as a whole in the United States, the balance between direct and indirect taxes is fairly well maintained, and there is not much need or likelihood of any great alteration in their present proportions.

Secondly, so far as the land taxes are concerned, the United States again has not much to learn from the recent development abroad. As we have seen, the system of land taxation in the United States is superior to that found anywhere else. Whether by accident or as a result of economic conditions, it is based on the capital or selling value of the land, combined with the system of special assessments for particular improvements. Neither of these systems, as we have seen, is accepted—at all events, neither is developed in anything like the same degree—in England, in Germany or in Australasia, and the movement for the imposition of land taxes in those countries is, on the whole, nothing more than an attempt to reach the position that has long been occupied by the United States. It is possible that our American system may be supplemented, by a small tax on the so-called unearned increment; and it is also possible that in certain portions of the country a partial or a

complete exemption of improvements from the land tax may be found desirable. But in many other portions of the country both of these projected changes will be found to be either unnecessary or undesirable. Thus in the main we may regard with equanimity the present situation of the taxation of land in the United States, as compared with that of the rest of the world.

In the third place, so far as inheritance taxes are concerned, the United States is rapidly approaching the practice that is found abroad. In some of our more progressive American states this form of taxation has already been well developed; in others the movement is well under way, so that here also no especial lesson need be emphasized.

It is on the two remaining points that the chief emphasis is to be laid. Income taxation in the United States is only in the very first stages of development. What has been successfully accomplished in England, in Germany and in Australasia, is, for the most part, only in the stage of discussion in the United States. A study of the recent reforms of taxation in the rest of the world cannot fail to compel the conclusion that the near future has in store for the United States some form of income taxation.

Finally, and above all, we are led to the conclusion that for the next few decades in the United States the most pressing question is to be that of the relations of federal, state and local finance. Scarcely a single problem connected with the more important direct taxes can be attacked, with any hope of successful solution, without a consideration of these important relations. That England, Germany and Australasia should all of them be devoting so much attention to this series of questions is a significant sign of the times, and from the discussions carried on and conclusions arrived at in these and other foreign countries we may hope to gain some light as to the disposition to be made in the not distant future, of the income tax, the inheritance tax and the corporation tax in the United States. The economic forces which are making the whole world akin are everywhere influencing taxation. With the increasing similarity in the conditions of economic life, it is not unreasonable to expect greater correspondence in the fiscal systems.

CHAPTER XVIII

RECENT LITERATURE IN TAXATION

In some respects the most significant fact of the recent development of economic thought is its growing international character. Not only does the modern economist find it necessary to draw his facts from a wider field than that of his own country; but if he desires to keep abreast of the advances in theory he also finds it incumbent on him to read many languages and to note the movements in widely distant countries. In no domain is this more true than in the science of finance. In the following pages an attempt will be made to run hurriedly over the productions of the period from 1885 to 1900 and in a general way to outline their value to the English-speaking student.

I. *Germany*

There are two methods of writing economic works. One is essentially historical and descriptive, giving an account of the past and of the actual state of legislation and of methods, and attempting to draw therefrom a statement of the underlying principles; the other is primarily abstract and deductive, making little use of history and of facts, but endeavoring to reach conclusions from well-defined principles. The modern German writers on the science of finance had for some time devoted themselves almost exclusively to the first method; but more recently a partial revulsion of feeling was indicated by the appearance of several works which attempted to avoid the exaggerations of the extreme historical school, and to take refuge once again in purely theoretic discussion. For Germany, this was a salutary reaction, because of the comparative discredit into which pure theory had fallen.

The Handbook of the Science of Finance by Professor Umpfenbach [1] is, strictly speaking, not a new work. But as the

[1] *Lehrbuch der Finanzwissenschaft.* Von Dr. Karl Umpfenbach, o. ö. Professor der Staatswissenschaften an der Universität Königsberg. Zweite Auflage. Stuttgart, 1887.

first edition appeared well-nigh half a century ago, and as some notable additions have been made to the present volume, it may be discussed as practically a new publication. The first edition was published just before the current toward historical economics had set in strongly; the second edition appeared just after the tide has begun to ebb. There are hence almost no vestiges of the inductive treatment. In fact, the strong points of the work are the rigor of the theoretic discussions and the precision of the definitions.

The general tone of the book is conservative. The author opposes the further industrial activity of the state, even in such domains as that of railroads; he has nothing but ridicule for the idea of the income tax in practical life; he declares that the question of progression does not belong to the science of finance at all, because it involves communistic changes of property. These contentions are interesting as giving the work the characteristics of the contemporary French rather than of the modern German authorities. As a matter of fact, they exerted no influence on German practice.

A more important point in Umpfenbach's book is methodology. The common division of public revenues by French writers like Leroy-Beaulieu is into domains, industrial undertakings and taxes, corresponding to Adam Smith's old division into revenue from public lands, from public stock and from taxes. The German writers, on the other hand, early saw this division to be inadequate and, as we know, added another category, fees. The exact definition of fees, however, has always been a mooted point; and few writers agree exactly on the distinction between fees and taxes. Umpfenbach defines fees as "special payments for the cost of a financial transaction, in so far as it is necessary for political purposes, and in so far as the expenses surpass those which it would be permissible to lay on the community as such." Passing over the minor infelicities of expression, we may say that at all events it conveys a precise meaning.

Had Umpfenbach rested here, his book would have rendered a substantial service to the clearing up of ideas. But he adds to his three categories of fees, taxes and domains a fourth category of fiscal (or lucrative) prerogatives, which are defined as "compulsorily reserved, exclusive rights of the state over specified kinds of property rights." The foundation of this fourth category is to be found in the mediæval *regalia;* but Umpfenbach makes it now include such widely diverse revenues as

the poll tax, taxes on communication, on the transfer of property, on legacies and successions, revenue from treasure-trove, from mines, salt, tobacco, spirits and bank monopolies, and finally from licenses. He lays great emphasis on this division; in fact, it is the thread which runs through the whole work. But the only result of its adoption would be undue restriction of the field of taxation, and an increased confusion as to the exact nature of taxes. What he gains by the separation of fees from taxes, he loses by the separation of taxes from fiscal prerogatives. His methodological explanation will not, on the whole, commend itself to students of finance.

Much the same class of questions is treated by Professor Neumann in his work entitled *Taxation*.[1] Neumann is well known as one of the prominent modern writers on finance. His book on *Die progressive Einkommensteuer* remains one of the best works on that knotty subject; and in that, as in all his earlier writings, is to be found a rich fund of historical and statistical information. In this newer work, however, Neumann has undertaken to analyze in detail the nature of taxation. The first volume, the only one that has yet appeared, is introductory and to a great extent methodological. The twelve chapters treat mainly of four topics: classification of public revenues, fees *versus* taxes, the principle of public interest, and direct *versus* indirect taxes. In the discussion of these points the author shows great acuteness and dialectic skill; yet three criticisms can be made. The discussion is too minute, and often borders on the wearisome; the style is anything but clear; and the conclusions are not advanced with the necessary precision.

After criticising the usual method of classification, Neumann defines fees as payments for special services of the state or the community, so far, but only so far, as the public interest is involved. This would include the tolls of roads, canals, railways and telegraphs, but would exclude the revenues from fiscal monopolies. He devotes over two hundred pages to the discussion of public interest, and finally defines it, but in so characteristic a manner that it must be given in the original:—

"Oeffentliches Interesse im (objectiven) engeren Sinne ist ein auf menschliche Handlungen oder Werke bezügliches Interesse von Zielen

[1] *Die Steuer. Erster Band. Die Steuer und das Öffentliche Interesse. Eine Untersuchung über das Wesen der Steuer und die Gliederung der Staats- und Gemeinde-Einnahmen.* Von Fr. J. Neumann. Leipzig, 1887.

oder Zwecken so grosser Bedeutung, dass um ihretwillen eine Auferlegung von Opfern nach herrschender Annahme gerechtfertigt ist."

In other words, two hundred pages are devoted to proving that a "public interest is an interest of such importance as to justify a sacrifice on the part of the individual." This might surely have been shown in less than two hundred pages, and without the formidable array of proofs and counter-proofs, of exceptions and sub-exceptions, which fairly crowd the book and bewilder the reader. To be over-exact is often as great a mistake as to be superficial, for either excess is apt to result in confusion.

Much better is his discussion of the four methods of classifying direct and indirect taxes. Neumann finally allies himself to Parieu's method, making the distinction depend on the permanence or periodicity of the act. Other parts of the book also will prove suggestive, as, for instance, his discussion of the relation between taxes and prices; but it might well have been boiled down to one-fifth of its present compass. Questions of methodology are not the all-absorbing ones.

The same criticism can certainly not be urged in the case of the new volume of Wagner's *Science of Finance.*[1] The first volumes of this great work are familiar to all students. Wagner started out over three decades ago with the idea of publishing a new edition of Rau's finance, but soon found his differences from Rau to be so great as to call for a new creation, instead of a new edition. The first two volumes of the work appeared years ago—the second in 1880. This third volume deals not with general theory, but with special questions in the history and practice of taxation. Unfortunately Wagner's plan was so comprehensive, and his method so productive of repetition, as to make the completion of the work doubtful. In fact as it progressed, Wagner entered into continually greater details which would have been in place only in a cyclopedia. The consequence is that it has taken him ten years to write the third volume, and that he has been able to discuss the present condition of French and English taxation only. Wagner himself seems to have tired of this minute method and now intimates that he can

[1] *Finanzwissenschaft.* Von Adolf Wagner. Dritter Theil: *Specielle Steuerlehre.—Uebersicht der Steuergeschichte wichtigerer Staaten und Zeitalter bis Ende des 18. Jahrhunderts.—Die Besteuerung des 19. Jahrhunderts. Einleitung: Britische und französische Besteuerung.* Leipzig, 1889. The first part of this, much enlarged, appeared in a second edition in 1910 under the table of *Steuergeschichte vom Altertum bis zur Gegenwart.*

scarcely foresee the time when the work will be finished. This is the more to be regretted because the systems of France and of England have already been made familiar to us by other good publications, while the condition of the remaining countries, which he has not yet fully treated, is far from being equally well known.[1] It is to be hoped that the work will not be left a torso. The present volume requires no especial commentary beyond the statement that in all his details of the history and practice of taxation, as well as in his general summaries of the French and English systems, Wagner remains true to the ideas advanced in the former volumes. He has continually in mind the demands of what he calls the socio-political principles—the principles whereby the government is looked up to as the regulator of the distribution of wealth, and taxation is regarded as an engine to redress inequalities of fortune. Much as we may dissent from the fundamental points of Wagner's general position, it must be conceded that he has developed his doctrines with consummate keenness and phenomenal learning, and that his *Science of Finance*, even though incomplete, still stands at the head of financial literature for the suggestiveness of its views and the wealth of its contents.

Professor Cohn's *Science of Finance*[2] is constructed on an entirely different method. It forms the second volume of the general *System of Political Economy*, the opening volume of which was published several years before. After a general introduction on the nature and history of the science of finance, the first book treats of the essence of government economy or of the public household, dealing with public functions, public expenditures, the history and development of public revenue, and the budget. The second book discusses the principles, history and actual systems of taxation. The third book is devoted to a presentation of German taxation. Finally, a fourth book treats of public credit.

The chief interest of the work lies in the first book and in the first chapter of the second book. The remainder of the volume is always interesting, as are all of Cohn's writings, but it contains

[1] The fourth volume, devoted to the details of German taxation, appeared in two parts in 1899 and 1901.

[2] *System der Finanzwissenschaft. Ein Lesebuch für Studierende.* Von Gustav Cohn, ord. Prof. der Staatswissenschaften an der Universität Göttingen. Stuttgart, 1889.

The Science of Finance. By Gustav Cohn. Translated by T. B. Veblen. Chicago, 1895.

nothing that can be called a real contribution to financial science. He is indeed, through his intimate acquaintance with Swiss financial methods, often enabled to illustrate certain principles more successfully than any of his predecessors, but in the main he follows the rather conservative lines of accepted views. The book on German taxation gives an excellent picture of the present situation, but is omitted in the translation. The chapters on public credit contain an admirable historical survey, but in matter of principle do not afford anything which cannot be found at least equally well said in Professor Adams' work.

It is otherwise with the discussion of the general principles of finance; for Cohn's treatment of the various kinds of public contributions marks a distinct advance. His classification of public revenues, although not completely satisfactory, is based upon an analysis of comparative private and public benefits, and is elucidated by some suggestive remarks. His description of the historical development of public economy is clearer than that of Roscher, and traces the chief lines of development with a master-hand. His short discussion of the principles of local finance is especially welcome when compared to the laborious and confused chapters to be found in other treatises.

Most striking is his treatment of the equities of taxation. Cohn shows that just as the accepted ideas of justice are a product of historical evolution, so the conception of just taxation has assumed a different form in every stage of human progress. He gives a sketch of the different ideas that swayed the public mind at various epochs, and then devotes himself in particular to a consideration of progressive taxation. The result of the discussion is the adoption of the principle of progression, not for Wagner's socio-political reasons, but simply because under modern conditions proportional taxation no longer corresponds to taxable capacity. Cohn seeks to define and to limit the principles of progression, and in connection with this gives a good history of the doctrine of the "minimum of subsistence."

Weak points are not lacking as, for instance, in his discussion of the incidence of taxation. Here, as in many other places, Cohn conceals the difficulties of the problem by the brilliancy of his style. As this brilliancy is entirely absent in the translation, the work has by no means received so favorable a reception in its English dress as it did in the original. It

will have served our purpose, however, to call attention to the points in which Cohn's book marks an advance on its predecessors. Wagner, Roscher and Cohn supplement one another. Wagner is more radical and audacious in his suggestions and illustrates his theories by a wealth of statistical material; Roscher is weak in theory but strong in history; Cohn seeks to keep the golden mean. Cohn's *Finance* is superior to all others in two respects,—in clearness of style and in philosophic breadth of view. We welcome this new accession to economic literature as one of the most important works of the decade, but very much fear that it will help the American student to only a slight extent.

A more recent text-book is by Dr. Vocke. As this is, however, in some respects simply the elaboration of an earlier work, we shall devote a few words to its predecessor. In this former work, entitled *Contributions, Imposts and Taxes*,[1] Dr. Vocke treats the subject in a somewhat peculiar way. After having won his spurs after half a century ago by his *History of English Taxation*, at that time the most meritorious work on the topic, the venerable doctor here attempts to find the moral basis and relative justification of the various taxes. The problem which he sets out to solve is that of the exact difference between direct and indirect taxation; and the conclusion to which he comes is at all events novel. In an introductory book he traces the literary doctrine of the basis of taxation in general, and divides the authors into three schools: the representatives of the contract or protection doctrine, including most of the earlier English and French works; the group which emphasizes the sovereign nature of the state and the duties of the subject, but without any deeper historical insight; and finally the socio-political writers, who like Held, Schäffle and Wagner, attribute to the state a compensatory duty in taxing away inequalities of fortune. Vocke strongly objects to the latter as involving a dangerous socialistic tendency, and asserts that such considerations do not at all appertain to the science of finance. Neither in these schools, however, nor in the works of the "independent" writers, like Neumann, Stein and Roscher, does he find an answer to the great question: What is the ethical basis of direct, as compared with indirect, taxation?

[1] *Die Abgaben, Auflagen und die Steuer, vom Standpunkte der Geschichte und der Sittlichkeit.* Von Dr. Wilhelm Vocke, geheimer Oberrechnungsrat. Stuttgart, 1887.

An answer, he thinks, is possible only through a study of historical development. With characteristic German thoroughness, but with what seems unnecessary detail, Vocke begins with a psychological analysis of the individual and traces the evolution of his economic condition and qualities through the family and tribe to the state. In the patriarchal stage, as in the family, the contributions of the individual to the support of the whole are compulsory, universal and proportional to property. In the feudal state the contributions of the vassal take the shape of personal services and of payments in kind, afterwards converted into money payments. Then begin the customs and duties, the fees and tolls, the excises or evil duties (*mala tolat*), all of which rest primarily upon power—upon the imperious necessities of the overlord. The legal basis is the princely prerogative, the *imperium;* in other words, naked force. Quite different from these veritable impositions are the taxes proper. Beginning as the *trinoda necessitas*, aids and contributions, they soon develop into poll, property, and finally into profit taxes. These taxes, properly so called, rest on voluntary contributions, not on mere force; they are universal, not special; their standard is personal ability, not mere expediency. In the tax there is a moral quality, in the customs and excises there is none.

This is the keynote of Vocke's book. The tax proper in its historical genesis is the direct tax, and connotes certain ethical ideas; the indirect taxes are properly not taxes at all, but imposts, and carry with them no moral implication. He makes a careful study of the development of indirect taxation in the next political form—the absolute monarchy; and he shows how and why the basis of direct taxation was changed from property to product. The remaining two-thirds of the work are devoted to a consideration of taxation in the actual or constitutional state. He concludes that the correct point of view has been won, and that future reform must proceed in the path of elaborating the direct taxes and of curtailing the indirect taxes.

Vocke's book may be termed a study in the philosophy of taxation. It contains no figures, and but few facts. The author's contention as to indirect taxation may be met by the reflection that justice cannot be the sole maxim of taxation; for the chief practical consideration is to balance the budget, and some taxes which are technically just may be practically unremunerative and therefore unserviceable. More-

over, Vocke fails to perceive that there are various kinds of indirect taxes, and that many of the imperfections of the older systems are removable. Yet, on the whole, he will serve as a useful antidote to such flimsy thinkers as McCulloch, who exerted so considerable an influence on English views on taxation.

In his later book entitled *The Elements of the Science of Finance*,[1] which constitutes the second volume of Frankenstein's *Hand- und Lehrbuch der Staatswissenschaften*, Dr. Vocke devotes himself to the discussion of general principles. It is a relief, after the huge and many-volumed German works on the subject, to find the science here treated as a whole and in so compact a form. In other respects, also, Dr. Vocke's work differs from most of its German predecessors. It contains almost no references to literature and it is written in a style calculated to interest the average layman. But to those acquainted with the work just discussed, the present volume will not bring much that is new.

Here, as before, he looks upon financial history simply as the medium of bringing out more and more clearly with every generation the idea of faculty. Here, as before, he confines the term *tax* to direct taxation and eliminates from the whole field of compulsory revenue the so-called *Verbrauchsauflagen*, or indirect taxes on consumption. His whole classification of revenues is very confusing. On the one hand he puts the private economic revenues, by which he understands those from the public domain and from the prerogatives as well as from industrial undertakings; on the other hand he puts the compulsory revenues, divided into fees, payments for transactions (*Verkehrsabgaben*) and taxes. Between these he puts another category, the so-called "mixed" revenues, which he again divides oddly enough into economic monopolies, fiscal monopolies and imposts (*Verbrauchsauflagen*). It will be seen how unmodern this is, and how little Dr. Vocke has profited by recent discussion both at home and abroad.

At the same time, in his treatment of taxation we find many good points, such as his examination of the place where a tax ought to be paid, involving some of the difficult questions of double taxation. A valuable feature of the book is the discussion of the norm of taxation and the measure of faculty, in which he treats successively of property, product and income.

[1] *Die Grundzüge der Finanzwissenschaft.* Von Dr. Wilhelm Vocke. Leipzig, 1894.

Undue stress seems to be laid on the second of these, although the author cleverly exposes some of the exaggerations of his predecessors. Most of the book is of interest chiefly to Germans; but as there are certain broad traits of industrial developments common to all countries, students of American and English finance will find in Dr. Vocke's volume many hints which can be fruitfully applied to conditions at home. The bibliography, especially as regards foreign literature, is weak. The book can, nevertheless, be recommended, with important reservations, to advanced students.

We come finally to the two volumes by the distinguished South German statesman and scholar, Dr. Schäffle, known to all students of fiscal problems since the appearance in 1880 of his important work on *Die Grundsätze der Steuerpolitik.*[1] Of his other contributions to social and political science it is not necessary to speak, further than to say that in many fields of scientific as well as of political activity he must be classed among the foremost writers and administrators on the European continent. His two latest volumes quite maintain his great reputation: they are exact, incisive, clear and up to date; and for the advanced student they present many points of view worthy of consideration. Yet, when the works are carefully analyzed, it will be found that most of the fundamental ideas are already contained, although, of course, in less systematic form, in the earlier work of 1880; and, to the average Anglo-Saxon reader, the disadvantages of the scheme of devoting two large volumes to the general and the special part of taxation will be more apparent than the advantages. The Germans love to be "*gründlich*" at all costs, and to devote a great deal of space in their scientific treatises to what impresses the practical man as savoring a little of metaphysics; and this we see especially in the general part of Dr. Schäffle's work. Another weakness of the work is inseparable from the method of treatment. The second volume, or special part, really depends, in many of the chief divisions, upon the discussion of the more fundamental problems in the first part. As a consequence we have a large amount of repetition. Most

[1] Dr. Albert Schäffle, *Die Steuern: Allgemeiner Theil.* (*Hand- und Lehrbuch der Staatswissenschaften. II. Abtheilung: Finanzwissenschaft. 2. Band.*) Leipzig, 1895; *Die Steuern: Besonderer Theil.* Von Dr. Albert Schäffle (*Hand- und Lehrbuch der Staatswissenschaften. II. Abtheilung: Finanzwissenschaft. 3. Band.*) Leipzig, 1897.

readers will therefore find the second volume, which contains in compressed form no inconsiderable portion of the first volume, at once more interesting and more valuable.

In the second volume the most important discussion is that of the classification of taxes, for upon this depends much of the distinctive value of the author's treatment. Dr. Schäffle divides taxes into direct and indirect; but he takes strong exception to the commonly accepted theory that it is only the direct taxes which correspond to the "faculty" of the individual. According to him the indirect taxes accomplish the same result, but in a different way. The direct taxes are intended, in his opinion, to reach the general or average taxable capacity of the individual, while the indirect taxes are intended to reach the "actual" or "special" or "individualized" ability. He is able to reach this conclusion, however, only by counting among the indirect taxes, in addition to the ordinary taxes on commodities and exchange, what he calls the *Bereicherungssteuern,* including the taxes on inheritances, on unearned increment and on lotteries, as well as some others not usually put into that category, like sumptuary taxes or so-called direct expenditure taxes. His whole discussion of indirect taxation thus becomes highly artificial, and by this arbitrary classification loses much of its merit. It is not likely that English or American writers will adopt his classification.

In the general discussion of principles Dr. Schäffle is quite up to date. He lays stress, for instance, on the modern problems connected with double taxation and with the treatment of corporations. To Germans the books will be of value because of the special importance attached to Swiss and American experience. For the average American reader there is still a great deal that is only of very secondary interest; but the advanced student will find in almost every chapter of the two works some food for thought. They are distinctly able works of an able man.

II. *France*

After the volume of McCulloch, published in 1853, no English work on the principles of taxation appeared for forty years. English and American readers were compelled to depend on German and French treatises; and, from greater familiarity with the language, more commonly on the latter. But since it has been, until recently, an unfortunate habit of many French

writers on finance to discuss their topics in happy disregard of the newest thought in other countries, it follows that even their most approved works on taxation give the reader only the French view, not the wider scientific or comparative view. This reproach to French literature has now been removed by the admirable work of Professor Denis, who is, however, not a Frenchman, but a Belgian.

Professor Denis made his reputation as an authority on finance some years ago with the valuable report to the city council of Brussels on the income tax, afterwards reprinted as a bulky volume. He thereupon gave courses of lectures on finance, which were subsequently published in book form under the general title *Taxation*.[1] The present volume gives the ground covered in 1886–87; a succeeding volume was to continue the subject so as to include the whole field of taxation, but never appeared.

The fact that these are published lectures contributes to the value, as well as somewhat to the shortcomings, of the book. The style is simple and clear, and the arrangement is logical and sharply defined; but on the other hand the lecture form has made it impracticable to give authorities for the facts and opinions quoted, except by a short bibliography at the close of each chapter. Furthermore, the details of the argument have not been pursued with such care as would be demanded in a work constructed on other principles. Many of the finer points, including some that are of permanent practical importance in other countries, receive no attention at all. The history and facts of taxation, again, are given only in a very fragmentary way. With all these qualifications, however, the book of M. Denis may be regarded as one of the most valuable works on taxation hitherto published. Its chief claim to recognition is not so much the views of the author, as the calm and unbiassed consideration of the doctrines of all his predecessors. The fundamental vice of many writers is the assumption that the views expressed by them are new; for ignorance of economic and financial literature is scarcely less common than ignorance of economic and financial facts.

Professor Denis, considering the science of finance as a sub-

[1] *L'Impôt.* Leçons données aux cours publics de la ville de Bruxelles. Par H. Denis, Professeur à l'Université. Première Série. Bruxelles, 1889. [Accompagné d'un] *Atlas de statistique comparée.*—Large folio, 25 plates.

ordinate division of sociology, and as distinct from political economy although having many points in connection with it, attempts to lay down the laws of the relations of these sciences. The greater part of the book is devoted to a discussion of the problems of justice, and to a consideration of the various direct taxes. On many of the important questions, such as progression, minimum of subsistence, incidence, the basis of taxation, *etc.*, readers who have been confined to French and to older English works will find a wealth of new ideas and a mass of interesting facts. Of course no work written by a European, or at all events by a continental, scholar can be expected to treat primarily of those questions which most interest and affect Americans; but if there is any science at all in finance, such works as this must be deemed of the greatest importance to Americans and Europeans alike. Some minor mistakes might be noted; as the statement that the idea of the differentiation of the income tax is to be ascribed to a German source. In reality the theory can be dated back to the beginning of the century in England, and it has been fully discussed in parliamentary reports and in scientific essays for many decades. But such smaller points must be overlooked in a consideration of the general tone and value of the book. The usefulness of the work is greatly increased by the accompanying volume of graphic tables.

France has of late been devoting more attention to practice than to theory. Since the standard work of Leroy-Beaulieu, published in the middle of the seventies, there are down to the end of the century very few books to be mentioned of wider scientific interest, if we except the brilliant little sketch by Léon Say published during the eighties. But France also has had her practical difficulties to meet, and it is to these practical questions that most of the recent writers have addressed themselves.

In France the discontent is of long standing. Almost every author for the last twenty years has been calling attention to the lack of system and to the glaring inequalities in the present practice of taxation. Ever since the war of 1870 repeated efforts have been made to supplement the direct taxes and to rid the country of some of the burdensome indirect taxes by the creation of an income tax; and the advantages of such a policy had been hotly discussed by both sides. In 1887 the strife was renewed owing to the proposition of Dr. Koenig, whose *mémoire*

on *A New Income Tax*[1] was considered so important that the project recommended in its pages was adopted by M. Dauphin, then minister of finance, and was introduced as a government measure.

Dr. Koenig holds that the imposition of an income tax assessed on the declared income of individuals is practically impossible in France. He finds that the experience of England and Germany all point to the same result—evasion has become a system, deceit the rule. A far better method appears to him to be to calculate the income by some outward sign, such as the house rent. The *contribution personnelle et mobilière* is already based on this principle which Dr. Koenig proposes to develop. It is a well-known fact that the lower we go in the social scale the higher is the proportion that house rent bears to total expenses or to income. Rent is an increasing element of expense in proportion as expenses decrease; the poor spend relatively far more than the rich. Dr. Koenig suggests a progressive rate of taxation assessed on the house rent, maintaining that this progressive rate will counterbalance the decreasing proportion that rent bears to expense. The plan is skilfully worked out; but, in common with all plans of taxing expense, it has one defect. What a man spends is no sure criterion of his income, or of his ability; and the higher you go, the more uncertain does the criterion become. The objection to the prevalent French system is that the wealthy escape their share of taxation; but a tax on expense, even at a progressive rate, while undoubtedly a step in advance, would not completely remove the objection. Dr. Koenig's plan has indeed the merit of doing away with all inquisitorial difficulties and of attaching itself to existing conditions; but it is at best a half-hearted measure, a mere temporizing expedient to be thrown as a sop to the radicals. It did not satisfy them, and the bill was finally killed in the legislature. The work is, nevertheless, interesting and contains much valuable information. The allusions to America are not always felicitous.

M. Guyot, in his work on *The Income Tax*,[2] sets himself a different task. The critics of the French system of taxation

[1] *Un nouvel Impôt sur le Revenu.* Mémoire qui a inspiré le projet du gouvernement relatif à la réforme de la contribution personnelle mobilière. Par Dr. Gustave Koenig. Paris, 1887.

[1] *L'Impôt sur le revenu: rapport fait au nom de la commission du budget.* Par Yves Guyot. Paris, 1887.

have always contended that personal property is unduly exempted. M. Guyot was requested by official authority to investigate their propositions for an income or for a general property tax; and his book furnishes a noteworthy addition to the studies previously made by Menier, Denis and Chailley. The report is one of description rather than of analysis, and the various parts are of quite unequal value. The account of the English income tax is neither detailed nor satisfactory. Attention, however, is called to the familiar fact that the English system is not a tax on general income, but on product, and that with the exception of schedule D (income from commercial pursuits, *etc.*) it may well be compared with the *contribution foncière* and the *contribution personnelle et mobilière* of France. The description of American taxation is exceedingly inadequate, and that of the German system is not much better. On the other hand, the working of the Italian law of 1877 taxing the income of movable property is fully explained; and a good chapter is devoted to the income and property taxes of the Swiss cantons.

M. Guyot is not a partisan of the income tax; he advances the common argument of the inquisitorial character of the tax, and discusses rather superficially the question of progression. The history of the various projects from 1848 onward is, however, well written and interesting. He thinks that France committed a grave mistake after the Prussian war in increasing the indirect taxes. He leans toward a general property tax, like that advocated by Menier; and in discussing the objection that the valuation is attended with great difficulties, he says: "La pratique des États-Unis et de la Suisse répond encore à cette objection." It is to be feared that this rosy view is caused by ignorance of American methods and results. His error shows the extreme danger of general analogies, and tends to make one sceptical as to M. Guyot's other propositions.

The practical outcome of the report is a proposal to reform the property taxes. The land tax, as imposed in 1790, is an apportioned tax. As a consequence, as early as 1821 the division between the departments and the communes was so unequal that in some cases the tax amounted to one-sixth, in others to only one-seventeenth, of the rent or produce. A general valuation or *cadastre* was begun in 1808 but was not finished until 1851; and in the meantime the valuation has again greatly changed so that at present the amount of tax paid varies from one to twenty per cent of the rent. As an escape from this cry-

ing inequality, Guyot demands its conversion into a percentage tax, in order that each plot may bear its proportionate burden. He would, moreover, have the tax levied on capital value, rather than on rent or annual value. A similar reform is suggested for the tax on personal property (*la contribution personelle et mobilière*), which since 1832 has been apportioned. These changes, together with an abolition of the duties on the transfer of land, amounting at present to ten per cent of the value, would in his opinion result in a far more equable and remunerative fiscal system, and would serve as an introduction to still greater and more important reforms. The student of comparative taxation will find in the volume many useful hints.

In a widely read work on *Financial Reform* [1] another remedy is proposed. The title is somewhat misleading, as M. Raynaud is the member of the society for financial reform who offered the prize, while M. Lorrain is the author of the essay which took the prize. M. Lorrain's plan, based on taxation of expense, is very simple. He would have the government abolish all existing taxes except the import and succession duties. In their stead the government would defray all its expenses through the issue of circulating notes payable in three years. These notes (*bons du trésor*) while outstanding, would be subjected to a tax of ten centimes per day for every hundred francs, the tax being paid by the holder, who affixes stamps for the requisite amount to the notes. The idea is that the notes are to form the sole circulating medium (with the exception noted below); and that, since every one must use them, every one will pay a tax in proportion to his expense. To provide for the exigencies of trade, all checks, drafts, bills of exchange, *etc.*, are subjected to a like tax. No note is to be issued under one hundred francs, so that the poor, who will continue to use small silver change, will be practically exempt. The sale of the stamps will defray all public expenses.

Were it not that this fantastic idea received the prize of two thousand francs, and that the society for financial reform circulated it extensively, it would not deserve notice here. Its absurdity is apparent. As a currency scheme it approaches dangerously near to the fiat-money craze; for the government will have no check on its extravagance, and the notes, like the assignats

[1] *Les Réformes Fiscales. Révolution pacifique par l'impôt sur les revenus.* Système de M. Jacques Lorrain, premier lauréat, *etc.* Par A. Raynaud, avec une preface d'Augustin Gallopin. Paris, 1888.

of old, must inevitably depreciate. As a tax scheme it is flagrantly inequitable, for the tax will be paid, not by the consumer, as is claimed, but by the debtor, whether he be producer or consumer. Even if paid by the consumer, it would be, like most taxes on consumption, regressive, or as the French say, *progressif à rebours*. Finally, it would fall harder on the working classes than on all others, because it would bring about compulsory purchases of commodities in order to get rid of the notes as soon as possible. To call such a tax *l'impôt sur les revenus* is a crass misnomer.

It would, however, lead us too far afield to pursue the study of practical tax reform in France. What primarily interests us here is the general scientific work in taxation; and with two exceptions the last decade of the century has little to show. The book of Professor Worms, on *The Science of Finance*,[1] is a smoothly written discussion of some general questions. The author displays familiarity with the older German literature; but, as he himself states, desires to give only an elementary account of some of the fundamental problems. He is on the whole very fair; but the book is not cléar-cut, and is not apt to exert a considerable influence outside of France.

A distinctly abler work is that of M. Stourm who has long been favorably known as the author of an excellent book on the *Budget*, as well as of the classic study on the *Finances of the old Régime and the Revolution*. It was natural, therefore, to expect that his new book on *General Systems of Taxation*[2] would be an important contribution to science. As a matter of fact, the work proves to be in some respects disappointing.

As in all the writings of M. Stourm, the reader will indeed find a simplicity and clearness that leave nothing to be desired. But some readers will question whether the simplicity is not in this case, at least, to some extent purchased at the cost of thoroughness. To the student who knows anything of the complexities of many of the problems, the *sang-froid* with which whole classes of arguments are either absolutely ignored or coolly brushed aside is surprising. M. Stourm is a conservative; but that he should treat the arguments of his opponents so cavalierly

[1] *Doctrine, histoire, pratique et réforme financière ou exposé élémentaire et critique de la science des finances.* Par Emile Worms, Professeur à la Faculté de Rennes. Paris, 1891.

[2] *Systèmes généraux d'impôts.* Par Réné Stourm, ancien inspecteur des finances. Paris, 1893.

is disheartening. The book has many admirable points; it brings clearly before us the real problems of French taxation, it abounds in felicitous illustrations, and it has some excellent criticism of certain French projects. Its chief defect is its insularity. Although it abounds in references to French works, only a single foreign author on finance is mentioned later than John Stuart Mill, and that one, an American, in a wrong connection and with a mutilated title. Not a word is said about the contributions to theory made by the Germans, the Italians, the Dutch and others, during the past ten or twenty years. Even as to the practical discussions, we find with a few exceptions little that has not already been said, although perhaps not with the same grace and skill, in other works. It may be alleged in extenuation that the book was meant to explain the French system of taxation; but there is nothing in the title to suggest this, and even in a discussion of the French system more regard should have been paid to general theory. The book also contains some errors of fact. The system of direct taxation in America is mentioned as a warning example of the "mixed system," or combination of the income tax with the property tax; while the general property tax, or "*impôt sur le capital*" is said never to have existed alone anywhere. The work is in a measure redeemed by a vivacity of treatment and a charm of style, unusual even among Frenchmen. Were it as erudite and profound as it is attractive, it would rank with the most remarkable books of the decade.

The latest work [1] of the indefatigable French publicist, Fournier de Flaix, although in two volumes, is only the first instalment of what promised to be a stupendous investigation, if it was ever completed. As a matter of fact the work remained a *torso.* To write the history of taxation throughout the world is not an easy task. To do it adequately, one would need to be not only a polyglot, but also an archæologist of no mean distinction. To depend upon secondary materials, as does our author, is not always completely satisfactory.

M. de Flaix's work is divided into four parts. The first treats of the ancient Oriental civilizations, from Chaldea and Babylon to Egypt and China; the second, of Greece; the third, of Rome; and the fourth, of the feudal epoch in France and the other European states. These four parts occupy very unequal

[1] *L'Impôt dans les diverses civilisations.* Par. E. Fournier de Flaix. *Première Série.* Paris, 1897.—2 vols.

spaces: two hundred and fifty pages are devoted to the Orient and antiquity, and the remaining five hundred and fifty pages to the middle ages. Even thus, however, there is a great deal of padding. When the author, for instance, speaks of the Slavs, he devotes over twenty pages to their origin and historical development and to an account of some of their economic institutions. All of this may be very interesting, but has little or nothing to do with taxation. What is noted of the Slavs is more or less true of the other peoples. It must also be observed that most of the space is devoted to that period of taxation with which we are the most familiar—that is, mediæval taxation, English and Continental. This field has been well worked, and it seems unnecessary to go over it again so much in detail. Nevertheless, some of his *aperçus* are very striking, as when he sums up the change from Roman to mediæval traditions, in the sentence: "L'impôt devint un droit de propriété pour les uns et une servitude pour les autres."

The chief criticism to be urged is that the author, while saying a great deal about economic and political conditions, generally fails to grasp the real connection between economics and finance or to call attention to those particular economic institutions which conditioned the fiscal development. Such statements as that the Arab is on the whole refractory to the notion of "taxes consented to and voluntarily paid" (p. 494), shows that M. de Flaix sometimes describes as national characteristics what are nothing more nor less than the inevitable accompaniments of certain stages of economic progress.

The two volumes of M. de Flaix cover a great deal of interesting and valuable ground; but, with comparatively few exceptions, they contain little that is not to be found elsewhere; and much of the information that they do contain is not put into its proper perspective. For those, however, who wish to have a convenient epitome of the earlier fiscal systems and a good general account of feudal finance the book may be commended.

III. *Italy, Holland and Spain*

In some respects the best work on certain lines of public finance toward the end of the nineteenth century was done by the two nations with whose literature we are less familiar,—the Italians and the Dutch. It is worth while to call attention to a few of their late books on general theory.

The Italians have always been remarkable for the avidity with which they have seized upon and attempted to assimilate foreign theories; and so it is with the application of the more recent doctrines of value to fiscal problems. Professor Ricca-Salerno's *Science of Finance*[1] is only a compendium, but it is noteworthy for its clear and succinct discussion of fundamental problems. It deals very little with facts, and never with details, but attempts to lay down guiding principles. It is in many respects more difficult to write a small work than a large one, and Ricca-Salerno might easily, had he so chosen, have expanded his volume; for his previous elaborate works on the *History of Fiscal Doctrines in Italy* and the *Theory of Public Debts* show that he is fully acquainted with all the literature of the subject. In this little work he discusses first what he considers to be the three principal doctrines of public finance,—the theories of consumption, exchange and production. Many of his observations are acute, but his criticisms as well as his conclusions are based chiefly on those of Sax. He treats of the doctrines of benefit and of faculty in matters of public revenue; but like most of the continental writers he distinguishes only between fees and taxes. Ricca-Salerno's attempt always to find the golden mean sometimes brings him into difficulties, as in the case of progressive taxation, which he says is not at all a matter of theory, but of practice. The doctrine of incidence is passed over a little too summarily, but the results of recent studies are shown in the application of the marginal utility theory to fiscal problems. On the whole the work is important, not only because of these newer views, but also on account of the eminently lucid presentation, in small compass, of the basic doctrines.

Not only Ricca-Salerno but other writers, young and old, have started out in their discussion from a consideration of the more recent theories of value. Professor Viti de Marco, in his *Theoretical Character of Financial Economy*,[2] endeavors to point out the resemblances and the differences between finance and economics, criticising the prevalent distinction between science and art, and pointing out the real nature of natural law in finance. In a more acute work on *The Scientific*

[1] *Scienza delle Finanze.* Di Giuseppe Ricca-Salerno. Florence, 1888.

[2] *Il Carattere Teoretico dell' Economia Finanziaria.* Di A. de Viti de Marco. Roma, 1888.

Data of Public Finance [1] Mazzola attempts to state the general characteristics of finance as a social phenomenon. He not only deals with questions of method, but devotes himself especially to the economic basis of taxation, taking issue in several points with Sax. His work, full of dialectic and of keen reasoning, is only for the most advanced student. It is, however, questionable whether any attempt to explain taxation solely as a form of value can ever succeed.

Professor Zorli goes a step further. Starting out with two works on *Fiscal Systems* [2] and on the *Italian Law of Taxation*,[3] he soon found it necessary to get a theoretical basis for his conclusions. This he sought in his *Science of Taxation*.[4] He tells us that neither the "concrete-abstract" method nor the historical method alone can solve the problems. For the science of taxation he claims a complete autonomy as the most important part of finance, but would include thereunder also the subject of fees. His classification of public revenues, incidentally remarked, displays some acute criticism of his German and Austrian predecessors, but is not wholly satisfactory. In the chapter on the causes of taxation, Zorli discusses at some length the views of Sax, and while conceding that subjective value and final utility play a considerable rôle in the interpretation of actual tax systems, he points out that they do not form the sole or even the most important explanation. The final chapter on the effects of taxation is based largely on the work of Cournot. In a still later book entitled the *Psychological Theory of Public Finance*,[5] he develops his own ideas a little more fully. His contention is that just as value and utility depend upon certain psychological processes, so taxation which deals with public value must be studied from the same point of view. In his chapter on the psychological basis, he discusses the Austrian school; in the succeeding chapter on the relations of political and economic sentiment to public finance, he develops the suggestive idea of Loria. But his whole treatment remains, so to say, up in the clouds; and it is often difficult to see the application to practical problems. Finally, Professor Conig-

[1] *I Dati Scientifici della Finanza Pubblica.* Di Ugo Mazzola. Roma, 1890.

[2] *Sistemi Finanziari.* Di Alberto Zorli. Bologna, 1885.

[3] *Il Diritto Tributario Italiano.* Di Alberto Zorli. Bologna, 1887.

[4] *La Scienza dei Tributi in rapporto alle Recenti Teorie Economiche.* Di Alberto Zorli. Bologna, 1890.

[5] *Teoria Psicologica della Finanza Pubblica.* Di Alberto Zorli. Bologna, 1890.

liani, in his *General Theory of the Effects of Taxation*,[1] gives a very abstract discussion of taxation regarded simply as an addition to the cost of production. He deals with the most fundamental problems; but the effort is a little too much for him, and the treatment of so far-reaching a set of questions is far from satisfactory. All these Italian works, however, show the undoubted impulse given by the modern doctrines of value and utility to the investigation of fiscal theory.

Somewhat similar is the impression made by the recent Dutch works. The writers of Holland are not so well known as they deserve to be. The contest between the schools, that has agitated Germany and Italy and has spread to England and America, has never affected Holland. The Dutch writers have pursued in harmony the even tenor of their way, accepting what was best in both schools, and developing on independent lines. This harmony is in great part due to the leader of the Dutch economists, N. G. Pierson, who from the very outset, accepted Jevons' theories. In fact, the marginal-utility theory of value had been accepted and developed in many of its applications in Holland years before the so-called Austrian school made itself talked of. On the other hand, Holland has not been lacking in those who have devoted themselves especially to the historical and statistical side of economics, without thinking, however, that they possessed all the truth. The science of finance was treated at a somewhat later stage of Dutch development, but with equal success.

One of the most recent treatises is Cort van der Linden's *Text-book of Finance*,[2] which deals in this volume only with taxation. After a general discussion of the nature and importance of public revenues, the author treats of the three divisions of taxation, as based respectively on the legal, the economic and the fiscal principles. The legal principles are those of equality of what he calls social policy, and of universality. The economic principles deal with the pressure and the shifting of taxation. The fiscal principles are those of adequacy, fixity, elasticity and innocuity or the least possible detriment to production and exchange. This division is perhaps not unexcep-

[1] *Teoria Generale degli Effetti Economici delle Imposte.* Saggio di Economia Pura. Del Dottor Carlo A. Conigliani. Milano, 1890.

[2] *Leerboek der Financiën.* De Theorie der Belastingen. Door P. W. A. Cort van der Linden. Hoogleeraar aan de Faculteit der Rechtsgeleerdheid de Groningen. The Hague, 1887.

tionable. An important part of the work is devoted to the administrative side of the public finance, such as the methods of payment, of control, of remedies and of penalties. This includes both an historical and a comparative discussion, and attempts to draw some general conclusions. The author divides taxes into those on product (*ontvangstbelastingen*), on expense, on exchange and on income; and he compares the systems in England, Germany, France and Holland. While not making any noteworthy contribution to theory, van der Linden's work is welcome as extending our material for a comparative science of finance.

A more important treatise is Pierson's *Handbook of Political Economy*,[1] of which the first part was published in 1884. Over half of the present volume is concerned with public finance; although many of the problems had several years ago been dealt with by him in his *Grondbeginselen der Staathuishoudkunde.* Pierson's treatment is characterized by broad touches. He is thoroughly at home in all the recent continental, English and even American literature, and tries to get to the bottom of many difficult problems. He is one of the first to attempt a comprehensive theory of incidence combining Schäffle's amortization theory with some more eclectic views. He sharply criticises Mill's treatment of the principle of equality of sacrifice, and constructs his whole theory on the principle of faculty. Everywhere the subject is treated with a master-hand. It is a work not so much for the beginner, as for the advanced student who desires to analyze more carefully the leading theories of modern public finance. Among the discussions to which he devotes special attention is that of progressive taxation, in the course of which he criticises the views of the other Dutch writers, which have been treated in detail elsewhere,[2] and whose influence is seen in the recent reforms of Dutch taxation described in another chapter of the present work.[3]

To mention only the Italian and the Dutch works would by no means exhaust the literature of value to the economist among the less well-known continental nations. Even in the Iberian peninsula there were signs of renewed scientific activity toward the end of the century.

[1] *Leerboek der Staathuishoudkunde.* Door N. G. Pierson. Tweede Deel. Haarlem, 1890. This second part appeared in an English translation in 1912.

[2] *Cf.* Seligman, *Progressive Taxation.*

[3] *Supra*, pp. 466 *et seq.*

The Portuguese work of Pereira Jardim on the *Science of Finance* [1] interests us more from the standpoint of fiscal practice than of fiscal theory. Not that theoretic discussions are absent from his book or without ability; but as the work is posthumous, based on lectures delivered several years ago, the field of discussion does not include the newer theories of the last decade or two. Leroy-Beaulieu and Parieu among the French, Rau and Jakob among the Germans are the latest foreign authors discussed. Pereira Jardim does not really add anything to theory; nor are his discussions in any way novel; but the history and description of Portuguese public finance, and the continual references to the inter-relations between Portuguese law and economics will be welcome to the student of comparative finance.

On the other hand, the two-volume work of Professor Piernas-Hurtado of Madrid, entitled *Treatise on the Public Economy*,[2] is interesting in many ways. Like the Italians and the Dutch, the Spanish writers have profited by recent foreign investigation, and treat many of the problems from the newer point of view. Piernas-Hurtado, while quoting liberally from Wagner and the other Germans, does not fear to take issue with them occasionally and preserves his own individuality. This we notice not alone in questions of theory, but in problems of practical politics.

The introductory chapter, on the history of the science, is valuable as calling attention to numerous Spanish writers, not alone of the seventeenth century when Spanish literature was still almost at the flood, but also of more recent times. The author points out the causes of the essentially individualistic trend of the nineteenth-century Spaniards, and the socialistic reaction of more recent years. The general features of the development are the same in Spain as in almost all the other European countries. Like some of his German models, Piernas-Hurtado devotes a number of chapters to the conception of the state, to economic life in general, and to the economics of the state in particular. He looks on public expenses as public consumption, but gives us here almost nothing but platitudes.

[1] *Principios de Finanças*, gusendo as Prelecções feitas pelo lente da Faculdade de Direito. Antonio dos Sanctos Pereira Jardim. Quarta edição. Coimbra, 1891.

[2] *Tratado de Hacienda Publica y Examen de la Española.* Por José M. Piernas-Hurtado. Cuarta edición. Madrid, 1891.

When we come to public revenues, however, it is different. He classifies these according as they arise from gifts, fiscal domains, public works, fiscal monopolies, taxes, eminent domain, fines or escheats; and devotes several chapters to each of the important classes. The most noteworthy point in his treatment of taxes is his view as to the basis of taxation. He discusses in turn expense, income and property, as bases, and finds each of them essentially defective. The really equitable basis of taxation he finds to be faculty, or the economic position of the individual as shown by his "liquid assets" (*el impuesto sobre los haberes liquidos*). By this term he wishes to denote the means of the individual as conditioned by his needs, or the proportion between income and property on the one hand, and the claims made upon him by expenses on the other. Piernas-Hurtado thus simply attempts to put into plain language the marginal-utility theory of taxation, as developed by recent Dutch and Austrian writers. He confesses that this alone will not remedy social evils, that it is not susceptible of an exact mathematical computation, and that it may give rise to arbitrariness; but he maintains that the other suggested bases of taxation disclose the same or greater defects. Regard for the individual position of the contributor is in his opinion the really important consideration. The vagueness of this test as a practical program of taxation will at once strike the reader; but Piernas-Hurtado is content to leave the discussion in the field of theory.

In treating of the various classes of taxation, he later makes many good and practical suggestions. The whole of his second volume is in fact devoted to the history and criticism of the state, local and colonial public finance of Spain; and he clears up much that Parieu and other writers have failed to explain. Like so many of the continental tax reformers, he sees the greatest promise of improvement in the substitution of direct for indirect taxes, and he devotes a considerable portion of his work to the proposed adjustment of the Spanish public revenues to the principles of uniformity and universality. Several chapters on the theories and practice of public credit, and especially on the budget and financial administration, conclude a work whose open-mindedness, clearness and wide range of view entitle it to an honorable place in the list of text-books of finance. That this is sorely needed is open to very little doubt on the part of the attentive reader.

IV. *Switzerland*

Switzerland is the only European country where the general property tax still plays an important rôle. It is the one state whose methods of taxation bear a close resemblance to those of the United States. It would, therefore, be reasonable to expect that a work of such prodigious proportions as that of Professor Schanz on *Taxation in Switzerland in its Development since the Beginning of the Nineteenth Century* [1] should be of the utmost importance to all Americans; and this expectation is realized. Rarely in the history of economic literature has a foreign work been published which is at all comparable to this in its value to the American student of finance.

Professor Schanz earned his reputation by the thorough work displayed in his *Englische Handelspolitik gegen Ende des Mittelalters*, published some thirty years ago, as well as by several minor works on the history of labor. In 1884 he started the *Finanz-Archiv*, which is still the only serious review devoted exclusively to the science of finance. In this periodical he has been publishing for the past few years detailed histories and descriptions of the tax systems of different German commonwealths, which have challenged admiration for their solidity and accuracy. Now he offers to the scientific world a work which stands unequalled in magnitude of scope and detail of treatment.

A word first as to the methods of the author. The opening volume is devoted to a sketch of the general development of Swiss taxation. A preliminary chapter treats of the federal taxes and of the general situation; a second chapter, of the general direct taxes in the cantons; a third chapter, of the licenses, succession duties, military tax, *etc.;* a fourth chapter, of the indirect taxes on consumption; while a final part is devoted to the questions of local taxation. The three following volumes take up each of the twenty-five separate cantons in detail; describe the history, not only of all the changes, but of all the attempted reforms; and close with a minute statement of the existing condition in each. The fifth and final volume contains the text of all the important tax laws and administrative ordinances for each canton since the beginning of the

[1] *Die Steuern der Schweiz in ihrer Entwickelung seit Beginn des 19 Jahrhunderts.* Von Georg Schanz. Stuttgart, 1890.—5 vols.

century. It will be seen at a glance how stupendous must have been the labor necessary to complete such a task.

Let us now endeavor to ascertain in what respects the work is important to Americans. Professor Schanz begins by accepting the theory advanced by the present writer regarding the historical development of taxation and the position of the general property tax in this development. He shows that Switzerland, like the United States, has retained the mediæval property tax up to this day; but he further shows that Switzerland, unlike the United States, has successfully endeavored to reconstruct its property tax and to supplement it by another system which has brought it more into harmony with the needs of the present century. The conception of general property as the basis of taxation has been permeated, gradually but with ever-increasing rapidity during the past thirty years, with the ideas of product and of income. The attempt to realize the principle of ability to pay has resulted in dissatisfaction with the old property tax and a remodelling of the whole system. The methods in the various cantons may be summed up as follows: (1) a property tax plus a general income tax; (2) a property tax plus a partial income tax; (3) a property tax plus a supplementary income tax, in the sense that only the surplus income above a certain percentage, supposed to represent the interest of the taxable property, is assessed; (4) a real property tax plus a general income tax. Only three of the smaller cantons still hold to the general property and the poll taxes; while only one canton clings to the once universal, but still more primitive, system of the land tax.

This is the one great lesson to be drawn from Swiss experience. It ought to be sufficient to silence all those enthusiasts who cry out for a retention of the present American system, and point with triumph to the only democratic republic in Europe as practising the same methods. On the contrary, the one great effort of the Swiss legislatures during the past half-century has been to supersede the general property tax, not necessarily by the income tax, but by some form of income taxation—by some system which, directly or indirectly, makes not property, but product, the basis of taxation. As Professor Schanz sums it up: "Ueberall drängt sich eben mit elementarer Gewalt der Gedanke durch, dass es doch nicht das Vermögen, sondern das Einkommen ist, welches man eigentlich treffen will."

The next striking fact in Swiss experience is this, that where

the general property tax is utilized as a subordinate part of the tax system, or is employed in more primitive communities, or with a low tax rate, it works fairly well. But as soon as an attempt is made to defray the larger part of the expenditures of advanced communities by the general property tax, thus necessitating a high rate, which in terms of income is equivalent to from twenty to thirty per cent, it is a lamentable failure—as much of a failure, in fact as in the American states. Human nature is about the same the world over, and where the conditions in Switzerland are at all comparable to those in the United States, the failure of the general property tax, as the chief source of revenue is equally marked.[1]

Let us now leave these two facts, which might amply serve as a text for a whole volume, and turn to some of the other points of interest. The author does not discuss the question of taxation of corporations as a whole, but presents the facts, the most important of which have been used in another chapter of the present volume. Other points upon which the Swiss experience is extremely instructive are the different rates of taxation for various kinds of property; the methods of assessment, according to market value, insurance value or par value; the exemption of church or other property; the distinction between funded and unfunded income; and the subject of double taxation in all its various forms. But the four chief points which deserve special emphasis are these: the methods of controlling assessments, the question of progressive taxation, the succession taxes and the system of local taxation.

Switzerland, like the United States, has tried all forms of assessment for the general property tax—self-assessment and official assessment, oaths and no oaths, publicity and secrecy; and these have proved equally inefficient. One institution, however, has been developed in the last few decades that is peculiar to Switzerland. It is that of the inventory (*Inventarisation*). As soon as a taxpayer dies, his entire property is seized by the government and held until an exact inventory is made. If this discloses fraud in the previous self-assessments, punitive taxes must be paid, ranging in some cantons over a period of ten years.

[1] This point was also subsequently emphasized by Cérenville, *Les impôts en Suisse*, Lausanne, 1898; and more recently by Bullock, "The General Property Tax in Switzerland," in *Addresses and Proceedings of the Fourth Conference of the International Tax Association*, Columbus, 1911, p. 53 *et seq.*

This method of control is based on the right idea; but it has its objectionable sides. It must be distressing, to say the least, to the family of the deceased when the tax officials clap their seals on the property, as it were in the very chamber of death. It has also its weak sides, for those who have even a short time to prepare for death commonly give away a large part of their property. Again, the inventory naturally becomes a less trustworthy guide the further back we go, so that at its best it can serve only as a partial index. But notwithstanding these defects, it has done good service in increasing the tax receipts, and it forms to-day one of the chief subjects of dispute in the Swiss cantons.

Another point which has attracted attention is that of progressive taxation. Switzerland has now definitively accepted the principle of graduated taxation, and the cantons apply it not only to inheritance and to income taxes but also to property taxes. Especially since 1870, a large majority of the commonwealths have inserted the principle into their constitutions, and only a few constitutions fix the limit of the progression. The system, far from causing any wholesale exodus or any such startling confiscation as we read of from time to time in the newspapers, has proved so satisfactory that, wherever tried, it has never been abandoned.

Thirdly, about two-thirds of the Swiss commonwealths have rounded out their system of direct taxation by taxes on inheritances and on bequests. This movement is an old one, and has gone hand in hand with the movement to supplement the property tax by an income tax. The United States are still in the first phases of the reform; for until very recently the agitation was confined to an extension of the collateral inheritance tax. Switzerland has passed beyond this phase, for its system applies to all inheritances and bequests, with a rate ranging from a fraction of one per cent in Zug, to as much as twenty-five per cent or even more for non-relatives in Uri.

Finally, the methods of local taxation are instructive. Only a few cantons pursue the same system for both local and commonwealth purposes. In most cases the income tax is a commonwealth tax, while the local tax is a property tax, and often a real property tax. In addition to the local property tax, however, we find very generally a local "household" tax, which is practically a system of poll taxation designed to reach some of those who escape the real property tax. The local tax system

is moreover marked by two significant facts. In the first place, the idea of progression, which is commonly applied to the commonwealth taxes, is absent in the local taxes, which are almost uniformly proportional. Secondly, the exemption of debts—mortgage debts as well as others—is permitted in state taxes, but it is allowed only to a very limited degree in local taxes.

Enough has been said to show the importance of Professor Schanz's work. It does not pretend to discuss questions of theory, and yet almost every page contains matter of more significance to the average American than whole chapters of some of the usual manuals of finance. In some few questions of finance Switzerland has a little to learn from us; in most matters we have important lessons to learn from Switzerland. What these lessons are has been only faintly outlined in the above remarks: but it is to be hoped that their full significance will ere long be appreciated by every American student and by every American legislator.

V. *England*

English economic literature has not hitherto been very fortunate in its systematic studies of fiscal problems. The writers prior to Adam Smith concerned themselves only with scattered questions of temporary practical interest, and dealt with them in the same scrappy manner which characterized their treatment of economic problems in general. There was, in England at all events, no true science of political economy; there could not well be a science of finance. Adam Smith, taking his cue, perhaps, from the French writers, for the first time sought to connect fiscal questions with those of social economy. In his happy way he combined the abstract discussion of fundamental theories with the explanation and criticism of actual conditions, avoiding on the one hand the metaphysical vagaries of the Physiocrats and on the other the plodding monotony of the German "cameralistic" complications. But while Adam Smith gave a decided impulse to the study of fiscal problems on the continent, and thus initiated a movement which has resulted in the elaboration of the modern science of finance, his success in arousing a like interest in England was far less marked, although his influence on English fiscal practice was great. The mighty genius of Ricardo, however, turned at once to the core of the problem. He confined himself almost exclusively to an investigation of incidence,

regarding a tax simply as an addition to the cost of production and treating all tax phenomena as mere illustrations of changes in value. Taxation with him became a minor part of general economic theory. So weighty was his influence that even Mill who in other parts of his *Political Economy* pursued a quite different policy, gave in his fifth book nothing but a succinct analysis of the shifting and general effects of taxation, scarcely deigning to descend to the facts of everyday life or to do more than touch upon the difficult details of principle. Although a few other writers did more than this, their discussions were forgotten amid the plaudits showered on Ricardo and Mill. Thus it happened that, while on the one hand we had numerous descriptive works, written for practical purposes, on the chief facts of public finance, and on the other hand numerous appendices to general treatises on economics, dealing with a few points in fiscal doctrine, there came to be an almost complete divorce between fact and theory. The practical writers did not concern themselves with theory, and the economists were for the most part content to work in what might be called a fiscal vacuum. McCulloch was the one important writer to form an exception, and he was not sufficiently successful to find either admirers or successors.

Another reason which may be adduced to explain the more rapid growth of the science of finance in France and in Germany was their relatively inferior fiscal system. It is not the excellence but the defects of economic life that have always led to the elaboration of economic theory. The shortcomings of mercantilism produced Adam Smith; the abuses of the *ancien régime* brought forth the Physiocrats; the dangers of levelling and the evils of the poor law gave us Malthus; the currency confusion and the corn law were responsible for Ricardo. Had there been no agricultural, no industrial, no commercial troubles, we should not have had Mill and the whole host of modern specialists. So with the problems of public finance. The abuses on the continent were so serious that they gave rise to important political contests, and thus led the scientists to attempt a general clearing up of vexed questions in fiscal policy. In England tax problems (with the exception of the free-trade controversy, which was far more than a mere matter of taxation) did not agitate the people to any great extent, and their solution was contentedly left to the practical common sense of the English statesmen. It is significant that in the one department of public

finance which did seriously enter into politics, namely, that of public debts, the English writers have done better work than those of the continent. But the comparative excellence of the English revenue and budgetary system, combined with the general prosperity, in themselves contributed to hinder the growth of fiscal theory.

Of late years the conditions have changed. The disproportionate increase in public expenditures and the immense development of local needs have materially strengthened the consciousness of fiscal pressure, while the growth of democracy on the one hand and the complications of recent industrial development on the other have brought to the front questions of theoretic justice which necessitate the revision of fundamental doctrines. In England as in America, fiscal problems have become no less important than in continental Europe. It is thus natural to expect henceforth a deeper study of the subject-matter by those who in the wilderness of confusing party contests blaze out the path of truth and progress.

Professor Bastable's book on *Public Finance* [1] is the first scientific result of this new interest in fiscal problems in England. His volume marks a distinct epoch in the history of English economics; for it is the first attempt to set before English readers the science of finance in its modern garb. To many it will introduce an entirely new set of discussions; and especially to the English reader who is not familiar with foreign tongues, the volume will be welcome. This will be our excuse for dealing with it so fully.

To all those acquainted with the *Theory of International Trade*, published a few years ago, as well as with his recent *Commerce of Nations*, Professor Bastable is known as a clear and careful thinker, without any intellectual vagaries, and with marked sobriety of judgment. The same traits conspicuously reappear in the present volume, and they are reinforced by evidence of accurate scholarship and familiarity with foreign literature. In order to be sure of one's own conclusions, one must first know what others have said; and it is the neglect of this elementary rule that consigns so much of so-called scientific writing to the waste-basket. It must not be supposed, however, that Professor Bastable is a slavish adherent of his foreign predecessors. His volume is by no means without independent suggestions; and

[1] *Public Finance.* By C. F. Bastable, LL.D., Professor of Political Economy in the University of Dublin. London, 1892.

it is precisely this independence of thought that invites occasional criticism.

In the first place, it is to be regretted that Professor Bastable does not employ the term "science of finance." It is true that "finance" is used in English to include private as well as public finance, and that several books on "finance," like those of Jevons and Giffen, deal chiefly with monetary problems. This unclearness, however, attaches to the word in foreign languages to almost the same degree. The French speak of *la haute finance*, and the number of titles on what might be called "private" or "monetary" finance is legion; yet this has not prevented them from using the phrase *science de finance* or *science des finances*, as the technical term for public finance. The whole matter was there discussed and laid to rest years ago by Joseph Garnier. In Italy and in Germany the matter of terminology has reached a similar settlement. It is therefore to be deprecated that Professor Bastable should not have pre-empted the phrase for English scientific use. Sooner or later we shall have to conform to the usage of the French and the Italians.

The introductory chapter on the history of the science gives a clear picture of the main lines of development. Some mention might, perhaps, have been made of the discussions in mediæval Florence, which in some points foreshadow modern doctrines. Moreover, if a fuller history of the science in England is ever written, attention will have to be paid to writers to whom may be traced much of what is to-day current coin in fiscal discussions. To speak only of nineteenth-century authors, Frend, Craig, Buchanan, Buckingham and Sayer will be able to hold their own with many of the German writers whom their compatriots delight to honor.

An important point in which the volume differs from some others is the inclusion of the subject of public expenditures. It is a difficult and delicate task rightly to proportion the space to be devoted to this topic in a work on finance. From one point of view public expenditure is simply administration; from another point of view it is political economy in the original sense of the term. How far government should assume definite functions is a problem of economic politics; in what manner it should actually carry on these functions is a problem of administration. Yet almost every political or administrative act involves some outlay, and is in so far a fit subject for discussion in systematic works on finance. Professor Bastable,

in dealing with this branch of his work, has avoided on the one hand unsuitable details, and on the other mere commonplaces.

It is in the next three books that are to be found most of the controverted doctrines, and it is naturally here that the critic will be apt to take issue with the author. Professor Bastable first takes up the classification of public revenues. He sees the inadequacy of the older continental division into taxes and lucrative prerogatives (*regalia*) and correctly relegates the latter class to the limbo of *überwundener Standpunkte*. But he is equally aggressive in his onslaught on the class of "fees," the creation of which he ascribes to "a want of analytic power in the originator." He simply distinguishes between taxes and what he calls in some places "semi-private economic income," and in other places "public economic income."

It will be questioned whether Professor Bastable is not here taking a step backward. He shows, it is true, the many inconsistencies of recent writers. But does it not seem unwise to cut the knot in despair of untying it? In refusing to acknowledge fees as a separate class, the author only creates fresh difficulties. Where, for instance, shall we put school fees? They are surely not industrial income; and Professor Bastable himself would not class them among taxes. And where shall we put the charges for marriage certificates, and sheriff's fees, and copyright payments, and a host of other similar receipts? The author later speaks repeatedly of "economic receipts" as different from fees, as well as from taxes, seeming to forget that in the earlier portions of the volume he includes fees in the "economic receipts." Further, why speak so frequently later of the "fee principle" as opposed to the "tax principle," if fees do not form a separate class?

Again, Professor Bastable sharply separates economic from compulsory receipts; but he fails to distinguish between different kinds of compulsory receipts, and assumes that all of them are taxes. Where, then, shall we put fines and penalties? They are certainly compulsory receipts, and just as certainly not taxes. Where, too, shall we put special assessments, which are completely ignored by him? In fact, it almost seems as if the author, in the endeavor to simplify matters, has really added to our difficulties.

A similar criticism may be urged against his classification of taxes. He objects to all the recent methods, and reverts

to what is virtually Adam Smith's classification into primary and secondary. But it is hard to see why a tax on the property of a living person should be primary, and that on the property of a deceased person, in the shape of an inheritance tax, secondary; or why a tax on the business of a corporation should be primary, and a tax on the receipts of a corporation secondary. It may also be noted that, when he calls attention to the distinction between direct and indirect taxes made by practical "financiers," his statement applies only to French, not to English or to American practice.

The book on the whole exhibits independent judgment, although in a few instances the author allows his German models to influence him unduly in matters of nomenclature. Thus he introduces the German distinction between the "object" and the "subject" of taxation, meaning by the former the thing on which, and by the latter the person on whom the tax is imposed. This is not English. When we speak of the subjects of taxation, we mean not the taxpayers (or "subjects," in Professor Bastable's language) but the phenomena subjected to taxation (or "objects," in Professor Bastable's language). And when we speak of the objects of taxation, we commonly mean the aims of taxation, not the things taxed. In other words, the author's (German) "tax object" is really the English "subject"; and his "tax subject" is the English "taxpayer" or "taxbearer," as the case may be. Again, the terms "forward incidence," "backward incidence," and "diffused incidence" are not English; moreover, they confound the terms incidence and shifting. Finally, when Professor Bastable employs the word "rated" tax as opposed to "apportioned" tax, he is ignoring the equivalent term, "percentage" tax, which has become quite common, and which clearly expresses the meaning on its very face.[1]

But all these matters, it may be said, are of minor importance. The crucial point is not so much the arrangement and terminolgy as the substance, and in the substance of the book the author must meet with greater appreciation.

Passing over the chapters on the state domain, the industrial domain, and the state as capitalist, in which he always seeks to maintain the golden mean between the *laissez-faire* theories of the earlier English writers and the semi-socialistic doctrines

[1] In the later editions some of these defects have been removed.

of the modern German authors, we come to the more difficult problems of taxation.

A good account is given of the theory of benefit, which is discarded as the general basis of taxation; but less satisfactory is the discussion of the theory of faculty. Professor Bastable speaks of its "convenient vagueness," but does not really make any serious effort to give a deeper analysis of the doctrine. He tells us of Mill's doctrine of "equal sacrifice," but does not succeed in correlating it with the doctrine of ability. His whole discussion of the theory of progressive taxation is therefore not quite up to the level of recent investigation. On other points, too, he is very conservative. He opposes the differentiation of the income tax, which was demanded by Mill, accepted by Disraeli and recently introduced by Lloyd-George; he seems to be opposed to graduation in the inheritance tax, which was also demanded by Mill and which has now been definitely introduced into English practice; and he even differs from the conservative French writers in disapproving of progression in the income tax as a counterpoise to regression in other taxes.

On the other hand, the discussion of the incidence of taxation is good. The author shows the weakness of both the diffusion theory and the absolute theories of Smith and of Ricardo, and calls attention to the complicating conditions of modern society. It might be urged that his analysis is not rigorous enough in the case of the taxation of profits; that not enough attention is called to the distinction between monopolies and competitive undertakings; that the house tax is viewed only from the characteristically English point of view as being assessed on the occupier; and that the general capitalization theory is not brought into due prominence. Nevertheless, the treatment as a whole is far superior to that found in most of the manuals on public finance.

Perhaps the least satisfactory part of the work is the discussion of universality of taxation. Double taxation, as we know, is of importance chiefly in federal states; and that is no doubt the reason why a book written primarily for Englishmen pays so little attention to it. But international relations are here of increasing importance and deserve more than the half-page alloted to them. Moreover, the conclusion itself is not beyond criticism. "The more modern solution," he says, "would be that the income tax should be levied by the country of residence, the land or property taxes by that of situation."

What, then, shall be done if the income is derived from land; or, conversely, if the property consists of intangible goods? Whatever we say about this, it is to be regretted that the author passes over the other forms of double taxation. Even if there were no space for details, the main points of the controversy should at all events have been outlined.

The following book, on the several kinds of taxes, shows the author at his best. A broad knowledge of the facts of taxation in all the important countries, and a wide acquaintance with the special literature, enable him to give a concise and clear account of actual conditions, as well as of the chief movements for reform. He suggests a judicious combination of the three principal forms of taxation as best calculated to reach substantial justice.

So far as the practical problems of American taxation are concerned, Professor Bastable opposes the suggestions for a direct income tax to replace the local tax on personal property, and he also deprecates the taxation of gross receipts of corporations. His statement that "the most promising sources of state revenue seem to be the real property and the license taxes" is, however, obviously a slip. Americans will also take exception to the assertion that "taxation of inheritances is unsuited for a community where the family is the unit of society and property is really held by corporations, not by individuals." There is an obvious discrepancy between this and the author's statement that "taxation of corporations is the taxation of their members." This last statement again is unclear. Do the "members" of a corporation mean its stockholders, or its bondholders, or both? The discussion of these questions, which have led to some of the most perplexing problems of public finance in America as elsewhere, ought not to be so lightly "eliminated."

We have not hesitated to call attention to some of the minor defects in Professor Bastable's volume or to indicate a belief that it will not be found wholly satisfactory for the American student. We must, however, remember that it was written primarily for Englishmen. It is to be hoped that no one will leave these criticisms with the idea that the book can be lightly cast aside. It is so admirable in arrangement, so accurate in statement, so catholic in temper, so sagacious in judgment, and so broad in erudition, that it will undoubtedly give a new impetus to the scientific study of fiscal problems in England.

VI. *United States*

When Professor Bastable's book appeared the hope was expressed that there might soon appear in America a similarly comprehensive treatise, intended primarily for our own public and dealing more specifically with the problems that are, in a measure, peculiar to the United States. This hope was soon realized by the publication of Professor Adams's *Science of Finance*,[1] which at once commanded attention as a signal contribution to economic literature.

That such a book is timely it is scarcely necessary to say. The United States has so rapidly outgrown the swaddling clothes of its infant economic surroundings, it has stepped with such prodigious strides from its youthful social environment to the complex conditions of a full-grown industrial society, that we are suddenly confronted on all sides by the new problems of political, economic and social maturity which are at present engaging the public mind. America presents in some respects most curious contrasts. It is at once the youngest and the oldest of economic societies—at once the most youthful and the most mature of social experiments. It is the youngest, in the sense that there are still in our territory vast tracts untouched by plough or harrow, awaiting the coming of the first settler and needing only irrigation to convert the desert into a garden. It is young, because there are other huge sections of the country which are only one step removed from the primitive agricultural stage, in which the local life is still largely dominated by frontier conditions—conditions analogous to those which the old world faced centuries ago. In another sense, however, America is not young, but old. Nowhere on the face of the globe has capital been applied to productive purposes with such intensity and such energy. Nowhere has man's victorious contest with the powers of nature been waged with such intelligence and with such relentless vigor. Nowhere have the captains of industry prosecuted their quest for industrial supremacy with such alertness and with such ability. As a consequence, nowhere have the most advanced forms of a highly organized, fully differentiated and thoroughly complex industrial organism been evolved with such startling rapidity and with such complete success.

[1] *The Science of Finance: an Investigation of Public Expenditures and Public Revenues.* By Henry Carter Adams, Ph.D., LL.D. New York, 1898.

In no department of social and political life have these warring forces engendered more confusion than in the domain of public finance. In former times the fiscal problem was comparatively simple. The collective wants of individuals were small in comparison with their private wants; public expenditure was insignificant; and the needs of government revenue were easily satisfied. With the growth of industrial democracy, however, all this has been suddenly changed. A scale of public expenditure which would have appeared absurdly lavish to former generations now seems barely adequate to modern necessities. The resulting prodigious increase in public revenues has called into being problems of the utmost nicety, not because the growth of these revenues is necessarily more rapid than that of the private wealth on which they are based, but because the constituent elements of this private wealth have in themselves become so complex and have so intertwined themselves with the integrated forms of modern industrial life. What is peculiarily confusing in the American situation is the fact that, on the one hand, we have sections where the economic conditions, and therefore the fiscal conditions, are still, as compared with the great mass of modern communities, of the primitive type; while, on the other hand, in numerous parts of these sections themselves there have been grafted upon the still dominant and persistent primitive stock the shoots of the newer industrial type; or, to put it in other words, although the basis of such communities is still primarily agricultural, the newer methods of transportation, as well as the more modern media of exchange and distribution, have superimposed upon the simplicity of the old and still persistent the complexity of the new and ever extending. The consequence is that the fiscal conditions of this country to-day are supremely heterogeneous and that, because of this contest of the old with the new, we are all still groping almost in the dark, dissatisfied in the more progressive communities with the survivals of old conditions, and trying to discern in the dim light of the future the fiscal expression of the newer conditions which are soon to become universal.

The appearance of Professor Adams's work bears eloquent testimony to this change of view. We have for a long time had American treatises on political economy, although these treatises have been, until comparatively recent times, for the most part simply copies of their English predecessors rather than adaptations to our own peculiar conditions. In the science of

finance, however, there have been no American treatises, just as there have been until recently no English ones, chiefly because the fiscal problems have been so simple as not to warrant any separate or extended discussion. An insignificant addendum to the ordinary work on political economy has sufficed for the consideration of the few questions that have presented themselves. For the reasons mentioned above, however, the fiscal problems have now come to the very forefront of modern controversy; and it is time for the science of finance to take its place side by side with economics in the narrower sense; for while economics proper is primarily social in its character, laying emphasis on the industrial relations of man to man, the science of finance, as a part of the broader political economy, is primarily political, laying the emphasis on the fiscal relations of the individual to the government. The appearance of a comprehensive treatise on finance accordingly marks a turning-point in the history of American political and economic literature; and when such a treatise attempts, as none of its English or continental predecessors have done, to call attention to the close connection between changing social and changing fiscal conditions, it is doubly deserving of attention.

A word should first be said regarding the formal arrangement of the volume before us. After an introductory chapter on the character of the science and the nature of public wants, the subject of public expenditure is taken up in Part I. The first book of this part deals with the theory of public expenditure; while a second book, to our surprise, treats of the budget. Why the budget should be dealt with under the general heading of expenditure is not apparent. It is true that much of the time spent in budgetary discussion in modern legislatures is devoted to expenditure; but there is also a revenue side to such discussion. Another departure from customary methods of arrangement is found in a subdivision of the book on the budget, in which Professor Adams discusses the subject of financial organization and administration. It may be urged that either this subject should be treated separately or the general heading of the book should be "Budgets and Financial Organization."

Part II. of the work deals with public revenue, taking up in three successive books the public domain and public industries, taxation and public credit. This arrangement is followed in pursuance of the division of all revenue into three classes: "direct," "derivative" and "anticipatory." While this distinc-

tion is clear enough, it must be said that the inclusion of credit under the head of revenue is, to say the least, unusual; and that the choice of the terms "direct" and "derivative," to mark the difference between income from the domain and income from taxation, is not entirely beyond criticism. "Direct" revenue is defined as that which accrues to the state from public ownership or management, or which falls to it by virtue of its sovereign character; and "derivative" revenue is that which forms in first instance a part of the income of the citizen, but which is paid to the state in satisfaction of some revenue law. It is further stated that "direct" revenue constitutes a positive addition to the social income, while "derivative" revenue is a transfer of a part of the earnings of the citizen to the state. In regard to the first point, however, it is to be noticed that all revenue from taxation falls to the state in virtue of its sovereign character; and that, on the other hand, much of the so-called "direct" revenue is originally a part of the income of the citizen and is paid in virtue of some revenue law. Post-office charges, for instance, are included by the author under "direct" revenue; yet the receipts originally form part of the income of the citizens, and are paid in virtue of a very definite revenue law—if by revenue law we mean a law which prescribes the raising of revenue. Again, referring to the second distinction, it must be noted that "direct" revenue, no less than "derivative" revenue, implies a transfer of the earnings of the citizen to the state. For, even if the government rents out its land, or runs its industries for profit, the prices are paid by the citizens, and the revenue involves a transfer of the earnings of the citizens to the state. While, therefore, the intent of the classification is obvious, it cannot be said that the nomenclature is a very happy one.

One other feature of the general arrangement may be mentioned. Within the separate books themselves there is nothing particularly worthy of note until we come to that on taxation. Here the arrangement is at once novel and interesting. Beginning with general considerations, successive chapters are devoted to the principles of apportionment; to the classification and characterization of taxes; to the manner in which taxes work, to the administrative consideration of taxes; and to suggestions for a revenue system. It may, perhaps, be urged that this necessarily gives a somewhat disjointed account, as there is no place where any particular tax can be judged as a unit from every

point of view. But no arrangement can satisfy conflicting claims; and it is undeniable that the one adopted in this treatise does succeed in putting a fresh aspect on some familiar topics.

Coming to the subject-matter of the work, attention must first be directed to the chief merit in the whole presentation—the masterly power of analysis disclosed by the author. The emphasis is everywhere laid, not upon facts and figures, but upon the principles involved; and to those who approach the subject for the first time, as well as to those already familiar with the general nature of the problems, the serried phalanx of argument upon argument, of closely reasoned analysis upon analysis, must be both a surprise and a delight. Not that all is new—for here, as in every other department of human thought, one can build only upon the basis of the known; but the whole work is so permeated with the doctrines of continuity, and of the essential dependence of fiscal upon economic conditions, that almost every single discussion is put in a new light. The insistence upon principle has indeed, as the French say, the defects of its virtues. With a few exceptions, we miss not only historical examples, but also any detailed statement of actual fiscal methods in America and any comparison with the institutions of other countries. The exceptions are to be found chiefly in Part I., devoted to expenditure, where the necessarily brief discussion of theory is pieced out with a separate chapter on "some facts." In the second part, however, dealing with public revenue, the student will, for instance, search in vain for any description of actual taxes, whether in the United States or abroad. Professor Adams evidently takes for granted that the reader is familiar with all such details, and he prefers to dwell on the more important matters of principle. It may be queried, however, whether he has not gone a little too far in this respect, and whether the book would not be still more valuable to the general reader, if it contained the essential facts as well as the interpretations to be put upon the facts.

In considering the work in detail the reviewer is obliged not only to call attention to the remarkable brilliancy and general solidity of the results, but also to attempt the less grateful task of noting the shortcomings that are inseparably connected with any such comprehensive effort.

In the discussion of public expenditures, the author brings out clearly their dependence upon the stage of industrial development. He lays down the principle that a profitable in-

vestment for a state is one which results in raising industry to a higher level of efficiency. From this point of view, increased expenditure is not necessarily an evil. Attention is also directed to the connection between public expenditures, on the one hand, and political conditions, as well as social organization, on the other. Perhaps the only point lacking in this analysis is a discussion of the influence of modern democracy upon expenditures, and of the gradual ascendency of the preventive over the repressive principle in modern legislation. A suggestive section compares the English with the German view of expenditures, with the conclusion that the English writers did not need any definite theory, because their conception of the state implied a fixed limit to governmental functions, while the more extreme German economists erred in setting up too strong a presumption in favor of the state. Professor Adams's position lies midway between the extremes of *laissez faire* and socialism.

In Chapter III. an attempt is made to classify expenditures in accordance with governmental functions. The classification adopted is that of "protective," "commercial" and "developmental" functions, including under the latter head expenditures for education, recreation, public investigation, maintenance of equitable conditions for the prosecution of private business and development of the physical basis of the state. It may be conceded that the particular classification adopted is not of so much importance as the method pursued in dealing with the principles themselves; but classification may emphasize or obscure principles, and the scheme employed by Professor Adams may, perhaps, be subject to criticism. Why, for instance, should the outlay for reformatories be called "protective" and that for schools "developmental"? Why should expenses for rendering justice be termed "protective" and those for maintaining "equitable conditions" for private business "developmental"? Why, in fact, are not all expenditures "developmental"? If it be claimed that protective expenditures look at the bad in human nature, and developmental expenses at the good, how can expenditures for the factory acts, for railway commissions and the like, be put by Professor Adams under the head of "developmental"? We may, indeed, desire to educate the good impulses of the factory owners and the railway managers; but precisely the same result is sought to be attained by a well-digested poor-law system, or a well-arranged penal system, or a good judicial system, all of which are classed under the head of "protective"

functions. And why the building of a railway is the exercise of a "commercial" function, while the building of a canal or dock is the exercise of a "developmental" function is still more difficult to comprehend. In fact, while the whole of this chapter on public expenditure is remarkably suggestive, it confuses things that ought to be kept separate, and it separates things that ought to be united. Moreover, almost the only question of principle that emerges from the discussion is the tendency of given expenditures to grow larger or smaller. Even here it may be queried whether the author gives due weight to facts like the tendency of expenses for justice to increase—not, as he says, to diminish. The explanation of this tendency is not that people grow worse as they become civilized, but that the complexity of modern industry is continually augmenting the chances of collision of interests and thus creating new classes of crime. In this detail Professor Adams has forgotten the general doctrine which he elsewhere so eloquently inculcates.

In the book devoted to the budget the author keeps closer to the beaten track. Attention may, however, be directed to two interesting novelties. The one is the series of suggestions looking to a reform of the American budgetary system. Professor Adams believes that this can best be accomplished, first, by the abolition of the committee on appropriations and the assignment of its duties to the committee on ways and means, together with the abandonment on the part of all other committees of their right to introduce appropriation bills; second, by the abolition of the right of individual initiative of money bills, as well as of the right of indiscriminate amendment; third, by a closer connection between the secretary of the treasury and this new budgetary committee. The reasons advanced for these changes, all of which are within the realm of legislative competence, seem to be in many respects sound. The other important discussion, to which only a bare allusion can be made, is the treatment of the theory of accruals as a basis of public accounting. Here not only is the plane of this discussion, as elsewhere in the book, an elevated one, showing on the part of the author a comprehensive grasp of the principles at issue, but, in addition, we have the satisfactory feeling of being in touch with the actual practice and the details of real life.

Part II. deals with public revenue. A section treats of the subject of classification, in the course of which it is to be noted that Professor Adams recognizes the existence of fees and special

assessments, and declares that they deserve an analysis separate from the general discussion of taxation. But after this frank confession—in which he takes issue with the English writers—it is a distinct disappointment to find no further discussion of these topics. The omission will be deplored, not only by those interested in the correlation between legal ideas and economic conditions, but also by those who believe that underlying our American practice there are some not unimportant questions of principle. The treatment of the public domain and of public industry, on the other hand, is characterized by much fresh and keen analysis. Occasionally, however, Professor Adams gets into difficulties—as, for instance, when he asserts that the phrase "quasi-private price" is inapplicable to governmental industry. His argument is that private prices, as "commonly" competitive, always seek the maximum profit, while public prices are adjusted to the idea of social utility. Nevertheless, not only does he speak, a little later, of the fiscal monopolies of government which seek to secure only profit, but he also calls attention to the private monopoly charges, adjusted to the standard of what the traffic will bear. Between the extreme of competitive private prices and social public prices there is a broad field to which neither term is applicable. This whole analysis is susceptible of improvement. Again, while the discussion of the principle of charge to be adopted by public industries is excellent, it may be questioned whether it is complete, and whether the treatment of the post-office, of the telegraph and of the telephone, for instance, might not be considerably amplified with profit. Finally, when it is stated that the industries fit for government ownership are primarily those which are subject to the law of increasing returns, Professor Adams forgets that this law can no longer be confined to industries dealing with transportation, but that the field of monopoly, so far as it is due to the existence of this law, is constantly growing in modern society. A more careful analysis would have shown a far greater complexity in the relation of the law of increasing returns to that of diminishing returns in actual industry.

We pass over the final book on public credit, where the author substantially sums up the well-known conclusions of his earlier work on *Public Debts*, in order to come to what constitutes at once the most solid and the most valuable part of the treatise—the book on taxation. This occupies 332 out of the 564 pages of the work. It is here especially that we see the excellent

qualities of the author and the break with the old English ways of regarding the subject, as well as the recognition of the changes necessitated by the newer structure of industrial society. The discussions of the essential nature of taxation, of the difference between the legal and the economic point of view, of the duty to pay taxes and of the principle of tax exemption, are at once striking and admirable. Not less noteworthy are the abandonment of the benefit theory of taxation, with all that that implies, and the acceptance of the progressive principle. The analysis which lead up to the relinquishment, not alone of the doctrine of proportion, but also of the theory of the general property tax, are as brilliant as they are profound. In one respect, however, Professor Adams seems to be laboring under a delusion. In his treatment of the general property tax he several times repeats the assertion that the secret of its success in the middle ages lay in the fact that the tax was assessed not on individuals but on the organizations within the town, and that there was thus a collective responsibility. Professor Adams is here confusing the town as a taxing unit with the organization within the town. It is true that in England, for instance, the town as such paid its *firma burgi;* but this was in no wise different from the situation in modern times, where the county or city pays a lump sum toward state expenses as its share of the property tax, or where, as in France, certain cities compound for the *octroi* duties. In the mediæval town, as in the modern American locality, this aggregate was distributed directly among the individual citizens according to their property. There is no warrant for the assertion that there was collective responsibility of any kind of a degree lower than the local community itself. Yet upon this mistaken assumption Professor Adams subsequently builds up a part of his scheme of reform. The only exception to the above statement was an arrangement in a part of Spain, an acquaintance with the failure of which would have preserved the author from this curious slip.

The classification of taxes followed by Professor Adams is instructive. He divides them into taxes on income, on property as the source of income, and on business as a means of securing an income. This is in some respects convenient; but it is no less open to objections than are the other classifications which he discards. Where, for instance, shall we put a tax assessed on the net profits of land? To the extent that it is imposed on land, it is a tax on property; to the extent that it hits the income of

the landowner, it is an income tax; to the extent that it reaches the business of the farmer, it is a business tax—unless indeed we arbitrarily confine the term business to non-agricultural enterprises. Again, where shall we put a poll tax? Moreover, in the chapter on incidence, Professor Adams recognizes another classification, that between direct and indirect taxes; but he makes no attempt to correlate these two distinct criteria of classification.

The chapter on the shifting and results of taxation is clear and seemingly convincing. But it may be queried whether the author has not here secured clearness and simplicity at the expense of accuracy. The conclusion that a business tax is "indirect," for all competitive occupations and "partly direct, partly indirect," for monopolies is not warranted. It implies that every tax upon a competitive industry is completely shifted to the consumer, while this is far from being the case. Moreover, the author's classification of goods into those produced at uniform cost, those produced at expanding cost, and those produced under conditions of monopoly is not convincing. He forgets that a distinction must be drawn between production at constant cost and production of various parts of the supply at different costs. A competitive industry may obey the law of constant returns (that is, it may be possible to produce more of the article at a proportionally greater outlay), and yet, under dynamic conditions of actual industry, the various parts of the supply are always produced at different costs, some producers being more efficient than others—else there would be no profits. The production of all parts of the supply at the same cost, in fact, always implies a monopoly, because monopoly profits alone are independent of any marginal producer. The development of this idea would take us too far afield; but it may be stated that Professor Adams's treatment of shifting is not entirely adequate. It must be noted also that here again only a few broad principles are laid down, and that, except as regards the tax on land, no attempt is made to apply the principles to the separate taxes. Another point, moreover, in which Professor Adams's exposition fails to command assent is his unqualified opposition to productive taxes. Here again he proves untrue to the general principle of historic relativity with which the rest of the work is permeated.

Perhaps the most interesting chapters in the book—certainly the chapters to which the ordinary reader will first turn—are those on "the administrative consideration of taxes" and on the

reform of the American revenue system. Professor Adams is opposed to a single tax of any kind, as well as to a direct income tax. As to the property tax, he advances the now familiar view that it should be confined to real estate and that it should be levied only by the local divisions. In the case of the corporation tax, he points out that net receipts constitute the proper basis of assessment, and that the taxation of interstate commerce falls naturally to the federal government. This would leave intra-state business, as well as inheritances, to be taxed by the states, while excises and import duties would fall to the nation. The municipal revenues, he thinks, should be supplemented by a tax on municipal monopolies, as well as by one on professional incomes, to be assessed on guilds that are to be created for the purpose.

While some of these suggestions are in harmony with the present tendencies,—with the exception of the rather fanciful scheme for guilds, which as we have seen, rests upon a misinterpretation of mediæval conditions,—the chief criticism to be urged is that the whole plan is based on the avowed principle that the "government must address itself to the industrial property, the industrial process or the industrial organization, rather than to the individual." From the point of view of administrative efficiency or of increased revenue this principle is exceedingly important; but it is hard to see how it can be made to square with the principle of the citizen's ability to pay, which the author accepts as the fundamental canon of taxation. If the property, the process or the organization can be regarded as the indirect source of income, well and good. But under Professor Adams's scheme, no such correlation is worked out. Corporation taxes, according to him, are to be confined to business essentially public in character; and even here it is not shown how the bondholders can be made to pay taxes. Ordinary business taxes are to be limited to a very few occupations, assessed by the federal government; and here again, according to his theory, the taxes will be shifted to the consumer. Thus the owners of some of the chief sources of modern wealth would virtually escape taxation; and the criticism which Professor Adams urges against schedule D of the English income tax may be turned against himself. It is hopeless to expect the American farmer to consent to an abolition of the general property tax, even in those states where the conditions are ripe for a change; just as it is hopeless to expect the American laborer to rest

content under an increase of the taxes he pays in the shape of federal excises, unless we show both the one and the other that our proposed scheme of reform is calculated, either directly or indirectly, to reach with rough but substantial accuracy the real earnings of those classes who are to-day fast getting into their hands the increment of social wealth. The earlier chapters of Professor Adams's book deal with problems of justice; the later chapters with questions of administrative expediency; and the conclusions reached from the first point of view do not always harmonize with those reached from the second.

We have not hesitated to call attention to the few points in which the treatise seems to invite criticism; but all these criticisms pale into insignificance when compared with the praise that must be accorded to the solid merits of the book. It is perhaps no exaggeration to say that Professor Adams is at the head of those American scholars who have grasped the essential spirit of modern industrial life; and it is likewise no exaggeration to claim for this volume the distinction of being one of the most original, the most suggestive and the most brilliant productions that have made their appearance in recent decades. At all events, it is safe to assert that, in America at least, the publication of this treatise marks an epoch in the discussion of fiscal problems. We may congratulate ourselves that we have in this country so masterly a representative of the newer and saner views as is the author of this remarkable work.

Shortly after the publication of Professor Adams's book, there appeared a work by one of the most distinguished exponents of practical tax-reform. In any catalogue of recent literature a prominent place must be awarded to a work that is at once new and old—the stately volume of Mr. Wells, on *The Theory and Practice of Taxation.*[1] The phrase "at once new and old" is used advisedly; for the book is new, in that it is the result of the studies and experiences of a long and useful life devoted to public interests, and in that it deals with a problem which is perennially fresh; and yet the work is old, because it restates doctrines that have been associated with the name of the author for over a quarter of a century, and because Mr. Wells had been so deeply immersed in certain

[1] D. A. Wells, *The Theory and Practice of Taxation.* New York, 1900.

parts of the problem that he has been unable to turn his attention to some of its newer and more important phases.

To the merits of the book it is scarcely necessary to call attention. Mr. Wells had scarcely an equal in this country in the ability to marshal facts from out-of-the-way and recondite sources in an attractive manner, and to present his results in a style so simple and so clear that they are sure of attracting the notice of the public; while his long experience in dealing with the difficulties of fiscal administration afforded him a unique opportunity for approaching the problems from a practical standpoint. Moreover, his intense Americanism, and his recognition of the fact that in a democracy like ours the legal and constitutional aspects of economic problems are of supreme importance, always made him careful to call attention to the adjudications of the courts and to consider the whole problem in the light of possible legal changes.

All these characteristics of his work are well illustrated in the present volume. Mr. Wells has ransacked the records of fiscal practice, so far as they can be found in the literature of English-speaking countries; he gives fresh and attractive accounts of the system, or lack of system, as it exists or used to exist in countries so unlike as Mexico, Egypt and China; he draws upon his own store of rich experience in connection with the system of internal revenue in the United States; and, finally, his quotations from the leading tax cases in the state and federal courts are so full, and in some respects so well selected, that the book possesses a value for the lawyer only second to that which it has for the economist.

Nevertheless, with all its good points, the work is in some respects distinctly disappointing. It is not, indeed, written primarily for the student, and, therefore, we need not consider it as a shortcoming that the author's acquaintance with scientific literature is limited to works in English. But Mr. Wells, as is evident from the title, proposed to treat the subject from the point of view of theory, as well as of practice. Now, it is well known that Mr. Wells was not especially strong in theory; and, whatever can be said of the work, no one can accuse it of over-precision in systematic treatment. A cursory examination of the table of contents will suffice to convince anyone of this. Mr. Wells possessed, indeed, so much common sense, such an instinct for what was practicable and expedient, that his conclusions are almost always better than his theory. It might

almost be said of him that he was often correct in spite of his theory, and not because of it.

His opinions are, as has been stated, precisely the same as those that were advanced by him thirty years ago; for the waves of recent economic discussion seem to have dashed unavailingly against his adamantine convictions. Thus, we still find it laid down as a fundamental doctrine that taxation for any other purpose than revenue is confiscation. His well-founded fear of the use of the taxing power for promoting private, rather than public, purposes drove him to the length of refusing to countenance the use of taxation for any public purpose other than revenue. It is significant, however, that we find in the entire book no allusion to the theory of high license or to the recent practice of American commonwealths in this respect. Mr. Wells is such an uncompromising partisan of free trade that he cannot afford to accept a principle which would even indirectly justify the imposition of a protective duty.

Again, we find among the maxims of taxation our familiar friend, the reciprocity or protection theory. It is true that Mr. Wells writes rather plaintively: "This assumption, it is believed, has been endorsed and accepted by every writer of repute on economic subjects who has discussed taxation, from the time of Montesquieu down to a very recent period." In the few lines that he devotes to the "very recent" doctrine, he complains that the antagonism to the old theory is wholly due to an inadequate comprehension of the subject; but, unfortunately, he does not aid us to a more adequate comprehension. Of a piece with this is the repetition of his familiar opposition to the theory of progressive taxation. He is somewhat hard-pressed, however, to find facts to justify his gloomy predictions; and, although he does refer in passing to the results in the Swiss cantons, which "are reported to have already verified the prophecies of the European economists," he does not attempt to explain how it is that the movement is commending itself more and more, not only to these Swiss cantons themselves, but to the European economists as well.

In the discussion of the distinction between direct and indirect taxes we meet the venerable error that direct taxes are compulsory and indirect taxes are voluntary—a statement the inaccuracy of which has been so often and so effectually exposed as to need no further comment here. Although Mr. Wells tells us (on page 356) that the British tax system has

been immensely improved in the past half century, through an extensive substitution of direct for indirect taxes, his opposition to any income tax is so strong that on page 516 he forgets what he has said before and approves Mr. Gladstone's statement as to the odious character of the impost which forms the very basis of the English fiscal system and which alone rendered possible the change from indirect to direct taxation.

The last three chapters of the volume are devoted to a restatement of the law of incidence and to the best methods of framing a system which will conform to this theory. Our old friend, the equal-diffusion theory, is again paraded in new and shining harness. Tucked away, however, on page 597 is a little sentence, the import of which must have escaped the notice of even the author himself. He says: "It is not, however, contended that unequal taxation on competitors of the same class, persons or things, diffuses itself." Even on the supposition of equal taxation, however, the strength of Mr. Wells's position can be gauged by his answer to the question he proposes on page 586: "Would an income tax on a person retired from business be diffused?" The reply is: "Yes, if the tax is uniform on all persons and on all amounts." For this statement the very convincing reason is adduced: "Would anyone pay the same price for a railroad bond which is subject to an income tax, as he would pay for it if it was free from taxes?" It is such essential incapacity to grasp a theoretical proposition that has made Mr. Wells's reputation among scientific thinkers rest on other grounds than the ability to draw logical conclusions from definite premises.

NOTE TO 10TH ED. The above chapter deals, as stated on p. 543, only with the period up to 1900. Since that date a number of significant additions to the literature of public finance have been made. We may mention in German: B. Fuisting, *Die Grundzüge der Steuerlehre*, Berlin, 1902; M. von Heckel, *Lehrbuch der Finanzwissenschaft*, 2 vols., 1907–1911; W. Lotz, *Finanzwissenschaft*, Tübingen, 1917; B. Moll, *Probleme der Finanzwissenschaft*, 1924; and the *Handbuch der Finanzwissenschaft*, ed. by W. Gerloff and F. Meisel, 1925; the Hungarian, Bela Földes, *Finanzwissenschaft*, Jena, 1920; the Swiss, J. Steiger, *Der Finanzhaushalt der Schweiz*, 4 vols., Bern, 1916, and the Scandinavian, E. Lindahl, *Die Gerechtigkeit der Besteuerung*, Lund, 1919; in French, the 7th ed. of Leroy-Beaulieu, *Traité de la science des finances*, 1906; the 6th ed. of Jèze, *Cours de science des finances*, 1924; L. Suret, *Théorie de l'impôt progressif*, 1910; in Italian, the 2d ed. of A. Graziani, *Istituzioni di scienza delle finanze*, Turin, 1911; Lorini, *Scienza delle finanze*, 1912; the 3rd ed. of L. Einaudi,

It is given to few writers, however, to be strong in both theory and practice. Let us be thankful that in Mr. Wells we have a man who is not, like so many would-be authorities, weak in both.

Corso di scienza della finanza, Torino, 1914; R. Murray, *Scienza pura della finanza*, Florence, 1914; B. Arduino, *Elementi di scienza delle finanze e diretto finanziario*, Brescia, 1914; G. Sensini, *Prime linee de finanza teoretica*, Laterza, 1917; E. Abate, *La diversificazione tributaria e l'imposta sul reddito*, Borgo S. Lorenzo, 1918; Salvatore Majorano, *L'imposta progressiva*, Rome, 1920; the 6th ed. of F. Flora, *Manuale della scienza delle finanze*, Livorno, 1921; the 5th ed. of F. Nitti, *Scienza delle finanze*, Rome, 1922, and M. Fanno, *Lezioni di scienza delle finanze e diretto finanziario*, Padova, 1923: in Spanish, E. Corbella Alerany, *Teoria economica de los impuestos*, Barcelona, 1914; F. Bernis, *La hacienda española*, Barcelona (1917); R. M. Magarinos, *Contribución immobiliaria*, Montevideo, 1914; A. E. Bunge, *Riqueza y renta de la Argentina, sui distribucion y su capacidad contributiva*, Buenos Aires, 1917; and E. Jaramillo, *La reforma tributaria en Colombia*, n. p., 1918.

In Great Britain there are to be signalized: G. Armitage-Smith, *Principles and Methods of Taxation*, 1906; W. Kennedy, *English Taxation, 1640–1799*, 1913; R. Jones, *The Nature and First Principle of Taxation*, 1914; J. A. Hobson, *Taxation in the New State*, 1919; Sir J. Stamp, *British Incomes and Property*, 1916, 2d ed., 1921; *The Fundamental Principles of Taxation*, 1921; *Wealth and Taxable Capacity*, 1922; and *Current Problems in Finance and Government*, 1925; H. Higgs, *The Financial System of the United Kingdom*, 1914, and *A Primer of National Finance*, 1919; M. E. Robinson, *Public Finance*, 1922; H. Dalton, *Principles of Public Finance*, 1923; and G. F. Shirras, *The Science of Public Finance*, 1924. In the United States we have to note the 4th ed. of Plehn's *Introduction* (1920); R. M. Haig, *The Exemption of Improvements from Taxation in Canada and the U. S.*, 1915; and *The Taxation of Excess Profits in Great Britain*, 1920; J. H. Hollander, *War Borrowing*, 1919; M. H. Hunter, *Outlines of Public Finance*, 1921; J. P. Jensen, *Problems of Public Finance*, (1924); H. E. Lutz, *Public Finance*, 1924; H. G. Brown, *The Economics of Taxation*, 1924; and several studies in taxation by L. R. Gottlieb, published by the *National Industrial Conference Board*, 1922–1925.

CHAPTER XIX

AMERICAN REPORTS ON TAXATION [1]

THE history of official attempts to reform the system of state and local taxation in the United States may be divided into several periods: the early period to 1870; the generation from 1870 to the close of the century; the decade from 1900 to 1910, and the final period from 1910 to the present.

I. *The Preliminary Period*

During the earlier period taxation was light and the tax methods were not yet out of touch with industrial conditions. The first report to deal with the subject was the the New York report of 1832.[2] This was concerned chiefly with the question of reimposing a direct tax the abolition of which in 1826 had been made possible by the success of the Erie Canal. The committee, deciding that public works were not a legitimate source of revenue, recommended the reimposition of the direct tax. A few years later another committee discussed the problem afresh and rendered a report [3] which came to the opposite conclusion. In the next decade a Connecticut report [4] took up the question of method and recommended the taxation of all

[1] In the present (ninth) edition this chapter and its successors have been much abbreviated, although the entries have been made more complete. Since this chapter originally appeared, a general study, expository rather than critical, has been made of this topic. *Cf.* J. W. Chapman, Jr., *State Tax Commissions in the United States* in the *Johns Hopkins University Studies*, vol. xv (1897).

[2] *Report of the Committee on Finance on so much of the Governor's Message as relates to the Finances of the State and the Report of the Comptroller relative to Loans. In Senate* [*of New York*], February 28th, 1832, 20 pp.

[3] *In Assembly* (*of New York*). *Report of the Committee of Ways and Means on the United States Deposit Fund and on the Recommendations of the Comptroller to levy a Direct Tax,* March 12, 1836, 37 pp. This was reprinted as *Report upon the Finances and Internal Improvements of the State of New York,* 1838, and issued in New York, Boston, and other cities.

[4] *Report of the Committee appointed by the General Assembly* (*of Connecticut*) *to inquire into the Subject of Taxation,* New Haven, 1844.

property at a uniform rate in lieu of the system of classification then in force. Seven years later this recommendation was successfully repeated by another Connecticut committee.[1]

The only other report of the decade was that of the Charleston commission.[2] South Carolina, like Connecticut, was still under the system of classification, property being taxed at different rates according as it consisted of real estate, stock in trade, securities, or earnings from professions. The report is a vigorous plea for the equal taxation of property, which is upheld in a grandiloquent but interesting passage forming one of the earliest defenses of the faculty theory:

> "Depending on the principle that the degree of protection given to property is the measure of taxation, the present system ignores the idea of the unqualified obligation of the citizen to the state and institutes a reckoning of benefits, a balancing of accounts between them, destructive of the sentiment of a high, pure, and devoted patriotism. The strength and beauty and glory of a people, the life and fortunes of the citizen abide in perfect obligation to the state and in the degree that both may be required for the common welfare, should they be cheerfully accorded."

In the meantime the rapid advance in wealth made the defects of the existing system more apparent. The New York report of 1863 [3] which is noteworthy also for the collection of comparative material, was the first to call attention to the "mass of wealth skulking and hiding from the tax-gatherers." The committee could not see their way, however, to recommend the listing system, but had much to say about exemptions and the taxation of mortgages. They compared the New York system to the English "composed of direct income and excise taxation," which they found too intricate for a young country. Two years later a Philadelphia report approved the method, followed in Pennsylvania, of subjecting securities to a lower rate of taxation.[4] Shortly thereafter two state commissions of the same commonwealth again discussed the problem, ad-

[1] *Report of the Joint Standing Committee on Finance upon the Subject of Taxation, with a Bill in Form,* Hartford, 1851, 59 pp.

[2] *The Disabilities of Charleston for complete equal Taxation, and the Influences of State Taxation on our Prosperity. A Report of the Committee on Ways and Means made to the City Council,* Charleston, 1857, 60 pp.

[3] *Report on the State Assessment Laws by the Joint Select Committee appointed by the Legislature of 1862.* Albany, 1863, 267 pp.

[4] *The Report of the Commissioners appointed under an Ordinance of the City of Philadelphia to revise the Laws relating to Taxation,* Philadelphia, 1865, 27 pp.

dressing themselves, however, to minor points,[1] as did a New Jersey report of 1868 which seemed to be helpless in the face of poor administrative methods.[2] In the same year another Connecticut commission again recommended, with similar lack of success, that a state tax commission be appointed.[3]

II. *The Period 1870–1900*

The real starting point of the movement for reform is to be found in the well-known double report [4] of the New York commission in 1871–72, written chiefly by David A. Wells. Not only did it contain a great mass of information as to actual facts, but it gave an account of the prevalent legal conditions, which is valuable even to-day. Above all, it attempted to lay down guiding principles. The practical question to which the report primarily addressed itself was the taxation of personal property. It took the position that in order to tax equitably, it is not necessary to tax everything; and it proposed to replace the existing tax on personalty by a taxation of house rent on the occupier. Significant also was the recommendation of a permanent central authority to supervise local assessors. Important as was its treatment of practical problems, the value of the report is somewhat impaired by two defects in theory—the espousal of the benefit theory in taxation and the defence of the diffusion doctrine of incidence.

The second important report of this decade is that of Massachusetts [5] which took issue with the New York commission on these two points. The theory of protection is shown to be inadequate and untrue; and the doctrine of faculty is now vigorously defended. The general diffusion theory is denied and some strong arguments are presented in opposition. As regards the practical question, however, the Massachusetts

[1] *Report of the Auditor General, Secretary of the Commonwealth and State Treasurer, on the Tax Laws of the State (of Pennsylvania)*, Harrisburg, 1867. —*Report of the State Tax Commission*, 1868, in *Pa. Legislative Documents of 1868*, pp. 345–433.

[2] *Report of Honorable Charles S. Ogden (and others) to the Legislature of New Jersey (on Taxation)*, Trenton, 1868.

[3] *Report of the Special Commission on Taxation*, New Haven, 1868.

[4] *Report of the Commissioners to revise the Laws for the Assessment and Collection of Taxes in the State of New York*, New York, 1871, 154 pp.; ditto, *Second Report*, Albany, 1872, 102 pp.

[5] *Report of the Commissioners appointed to inquire into the Expediency of revising and amending the Laws relating to Taxation and Exemption therefrom*, Boston, 1875, 177 pp.

commission sought to uphold the existing system. The New York commission's suggestion of a partial substitute for the personal property tax in the shape of a tax on rentals, was good so far as it went, but not sufficient. The Massachusetts report discerned this shortcoming; but because the commission did not see their way to expand the suggestion or to propose an additional substitute, they threw over the whole plan and maintained the adequacy of the existing system. On the other hand the New Hampshire report of 1876,[1] followed in the main lines of the New York report.

The next decade brought with it new problems. In addition to the taxation of mortgages and of personal property in general, the public was now beginning to consider the relations of local to state revenue, the growing intricacies of interstate taxation, and the corporation tax. The New Jersey report of 1880 [2] and the Connecticut report of 1881 [3] agreed in recommending both the listing system and a system of state control. The New York commission of the same year [4] marked the beginning of a new era by attacking the task confided to them of "providing revenues for the state government by a special tax on corporations and particular classes of business, and thereby to limit the general taxes to be imposed in the local communities exclusively for the support of local governments." The other states were not yet prepared for such a step. The New Jersey report of 1883 [5] contented itself with recommending some improvements in the taxation of railroads, and the West Virginia commission of 1884 [6] seemed not to know what to do with intangible property. The Connecticut commission issued

[1] *Report of the Legislature of New Hampshire of Hon. George Y. Sawyer, Chairman of the Board of Commissioners to revise, codify and amend the Tax Laws of the State and for the Establishment of an Equal System of Taxation*, Concord, 1876, 52 pp.

[2] *Report of the Special Tax Commission of the State of New Jersey*, New Brunswick, 1880, 27 pp.

[3] *Report of the Special Commission to inquire into the Conditions and Workings of the Tax Laws*, New Haven, 1881.

[4] *Decisions, Opinions and Statistics compiled by the Tax Commission with their Report, Presented to the Legislative Joint Tax Committee of New York*, Albany, 1881.

[5] *Report of the Special Committee of the House of Assembly as to the Taxation of Railroads and other Corporations in this State*, Trenton, 1883, 20 pp.

[6] *West Virginia Tax Commission, Preliminary Report*, Wheeling, 1884, 48+vi pp.+45 pp.; *West Virginia Tax Commission. For its Final Report*, (1884), 26 pp.

two rather inconclusive reports. In a preliminary report [1] they recommend the apportionment of taxes according to population instead of property. As this seemed to be too radical, however, they fell back, in their final report, [2] upon the listing system, although they coupled this with recommendations for a state tax commissioner and for the abolition of the tax on intangible personalty. The last recommendation led to the introduction two years later of the low-rate flat tax on intangibles.

The Illinois report [3] of 1886, although slight in bulk, is noteworthy for its advocacy of a divorce of state from local revenues. The commission suggested that the property tax be confined to the localities, and that the state revenues be secured from corporation taxes. The plan was not entirely new, for a New York commission had already advanced the idea a few years before; [4] but we now find it worked out for the first time in a state of the Middle West. In the same year appeared the report of the Baltimore commission [5] which proved to be the basis for the state report [6] issued two years later. Each commission had the good fortune to number among its members a student who had given considerable attention to the subject. Professor R. T. Ely not only succeeded in inducing the commissions to accept some noteworthy conclusions, but added to the city report some independent suggestions and to the state document a supplementary report. Advocating a total exemption of personal property, he proposed the exemption of real estate from state taxation; taxes on corporations, and an income tax as the chief sources of state revenue; a tax on real property and on the rental value of business premises as the chief sources of local revenue. The most significant parts of the report are the detailed criticism of the general property tax, and the proposal to utilize for sources of municipal revenue what Professor Ely termed the natural monopolies.[7]

[1] *Preliminary Report of the Special Commission on Taxation*, New Haven, 1886.

[2] *Report of the Special Commission on the Subject of Taxation*, New Haven, 1887, 116 pp.

[3] *Report of the Revenue Commission*, Springfield, 1886, 70 pp.

[4] *Cf. supra*, p. 368.

[5] *Report of the Tax Commission of Baltimore*, Baltimore, 1886, 64 + xlvi pp.

[6] *Report of the Maryland Tax Commission to the General Assembly*, Baltimore, 1888, 200 + cii pp.

[7] Professor Ely's supplementary report was subsequently reprinted with

Appended to the report is an interesting historical sketch of taxation in Maryland.

Partly as a result of the Maryland report, but chiefly as an outgrowth of the discontent now manifested in other sections of the country as well, tax commissions multiplied. In 1890 the Maine commission issued its report [1] which contains a digest of the legal provisions then in force in the most important states on the listing system, equalization, the poll tax, the dog tax, and the taxation of railways, insurance companies and savings banks.

The commission concluded that the failure to reach personalty might be overcome by requiring sworn detailed inventories. The value of the ideas may be gauged by the statement that the single tax on land values is the system which most European countries have adopted. When the present writer wrote to the commission for an explanation, the answer was that they had learned this fact from one of his own articles! Further, in discussing the income tax (which they reject) they repeat the statement that to tax property and income from property is intolerable as double taxation. The report is redeemed, however, by some wise suggestions as to the taxation of mortgages, culminating in the recommendation of the Massachusetts system. In regard to new taxes, the commission propose a collateral inheritance tax, a tax on private and special acts passed by the legislature, and an extension of the corporation taxes.

Of more importance is the Pennsylvania commission of 1890.[2] The majority report, while disclaiming any attempt to change state taxes, proposed to improve the local system by compelling every person to answer a list of interrogatories as to his personal property. Furthermore, transportation companies were to be made liable to local burdens by a tax on the average value per mile of the entire property multiplied by the mileage in the county. As a result large cities in which the terminals are of immense value would get no more revenue than little villages. In short, there is scarcely a recommendation in the report which does not contradict the teachings of sound finance.

additions, and published as his well-known work on *Taxation in American States and Cities*, 1888.

[1] *Report of the Special Tax Commission of Maine*, Augusta, 1890, 192 pp.

[2] *Report of the Revenue Commission appointed by the . . . Legislature of Pennsylvania*, Philadelphia, 1890, 198 pp.

The three minority reports as a consequence savagely attacked the majority. The auditor-general proposed that the commonwealth treasury should assume a further share of the local expenses, or that it should relinquish to the counties more of its surplus revenues. Mr. Bolles approved of the income-tax project to be mentioned in a moment, maintaining that the chief revenue of the state should be from railroads, and that most of the other subjects of taxation should be surrendered to the counties. The chief contribution consists of the three papers by John A. Wright. He laid down twelve principles, which may be summed up in the demand for a general income tax. His plan was that the state should tax the net income of corporations, the amount of sales of all merchants, and the gross income of all individuals from trades, professions and occupations. On the other hand, he would have the local divisions tax real estate, horses, mules, oxen and vehicles, and levy certain licenses.

There are many striking points in Mr. Wright's papers. His scathing criticism of the majority report, his appreciation of the injustice of the property tax, his argument that revenue and not property should be the basis of taxation, his proof that an income tax is really less inquisitorial than a property tax, his grasp of some of the difficulties of interstate taxation—all these put his three papers in the front rank of the literature on American finance. On the other hand, whole subjects—such as the question of graduated taxation, of the distinction between permanent and precarious incomes, and double taxation—are ignored. Furthermore, there are evidences of immature, or at all events of not sufficiently penetrating, thought—as on the subject of debt exemption, on incidence (where the diffusion theory is again dished up); on the protection theory of taxation; and on deductions from income. But with all its faults, his report is one of the best official documents hitherto published.

As a result of the tax-commission report of 1890, a bill was introduced in the Pennsylvania legislature, but met with opposition sufficient to defeat it. It was thereupon proposed by one of the senators that representatives of the different interests be called together to ascertain the facts and to report a bill. As a consequence, twenty-four representatives of agriculture, transportation, labor, commerce and manufactures, and tax officials met at Harrisburg early in 1892. This conference ap-

pointed committees to examine the value of the various classes of property in the commonwealth; to study the tax laws of all the states; and to formulate a statement of principles. The first to render a report was the committee on tax laws. This report[1] is valuable chiefly for the tables which digest the tax laws of the Union. The committee make but few recommendations—generally of a sensible character. They maintain that an income tax will not be equitably levied by locally elected officials, and that a single tax on land values will increase the burden on the poor. They find the best features of the Pennsylvania system to be the separation of the sources of state and local taxation. The next to report was the commission on valuation which[2] attempted to ascertain actual values by taking the insurance valuations on insurable property, and by making special investigations through separate agents.

Reports on the valuation of railroads, other transportation companies, manufacturing corporations and real estate[3] soon followed. At the conclusion of its labors the conference submitted a bill to separate state, county and local sources of revenue. The state taxes on inheritances, on commissions, on municipal loans and on certain licenses, as well as the local real estate tax were left unchanged. But the bill transferred certain taxes and fees from the state to the counties; and the tax on horses and cattle from the counties to the minor civil divisions. It also changed the state taxes on corporations. Although the bill finally failed to become law, the conference

[1] *Report of the Committee appointed to examine the Tax Laws of other American States and report an Opinion for or against the governing Principles embraced therein*, 1892, 18 pp.

[2] *Valuation, Taxation and Exemption in the Commonwealth of Pennsylvania. A Report by the Commission on Valuation and Taxation*, Joseph D. Weeks, Chairman, Harrisburg, 1892, 34 pp.

[3] *Valuation and Taxation of Railroads in Pennsylvania*, Harrisburg, 1893, 18 app. *Selling Price, Assessed Valuation and Taxation of Real Estate in Pennsylvania*, (1893), 20 pp.; *Minor Reports on Street Railroads, Canal Companies and Mortgage Indebtedness* (1893). *Cf.* also: *The Niles Tax Bill, An Analysis of its Provisions.* By the *Chairman of the Tax Conference*, 1893, 15 pp.; *Effect of the proposed Revenue Bill on the State Revenues.* By Joseph D. Weeks, *Chairman of the Tax Conference*, 1895, 18 pp.; *An Analysis of the Revenue Bill.* By C. Stuart Patterson, a member of the Tax Conference, 1895, 23 pp.; *Speech of C. Stuart Patterson on the Taxation of Railroads.* 1895, 24 pp.; and M. E. Olstead, *Riter Tax Bill*, 1895, 36 pp.

was a novel experiment, based entirely on voluntary action, and the work was taken up in the proper spirit. If the practical results did not amount to much, it is probably due to the weakness of human nature and to the inherent difficulties of the task.

In the meantime a few other commissions were at work. The Oregon report of 1891 [1] was insignificant with the exception that it proposed the abolition of the mortgage-tax law. In Boston the situation was so unsatisfactory that two reports were issued—the tax committee of 1889 [2] recommending an inheritance tax and the securing of revenue from municipal monopolies, while the commission of 1891 discussed the problems of double taxation and the exemption of personalty.[3] The New Jersey commission handed in a confessedly imperfect report, composed largely of extracts from previous commissions and showing that it had not made much independent study of the subject.[4]

Passing over the report of the Iowa commission of 1893 [5] which was of little consequence, we come to the report of the Delaware commission which consists of two parts.[6] Delaware raised its state revenues from corporation taxes and licenses, but depended for its local revenues upon the poll tax, the tax on real estate, and on a few kinds of tangible personalty. The farmers desired to reach all owners of personalty. The majority report approves of this desire, recommends that intangible personalty be taxed, that a tribunal be created for equalizing county assessments, and that the collateral inheritance tax be reimposed. The minority, on the other hand, object to the taxation of intangible personalty. Almost the whole of the report is an abridgment of the New York reports of 1871–72 and of the Maryland report of 1888, showing the injustice of the general property tax. Although the commissioners sym-

[1] *Report of the Special Senate Committee on Assessment and Taxation*, Salem, 1891, 10 pp.

[2] *Boston Executive Business Association. Report of Special Committee on Taxation*, Boston, 1889, 32 pp.

[3] *Report of the Special Commission in Taxation*, Boston, 1891, 29 pp.

[4] *Preliminary Report of the Commission on Taxation made to Governor Abbott*, Trenton, 1891, 25 pp.

[5] *Report of the Revenue Commission of the State of Iowa*, Des Moines, 1893, 66 pp.

[6] *Report of the undersigned Members of the Delaware Tax Commission to the General Assembly*, 2 parts, Wilmington, 1893, 32 pp., 16 pp.

pathize with the complaint of the Delaware farmer, they think that under the present system the taxes are "more equally distributed than in any other state."

More important are the New York reports of 1893, one [1] by the counsel to revise the tax laws, the other [2] by a joint committee. The counsel suggest that the information obtained from their researches be collated for the use of the public for further reference; but in the present report they prefer simply to present their conclusions. They object to the "building occupancy" tax, because the legislature refused to adopt it in 1872; to the single tax, as unequal; and to the income tax as inquisitorial. They also object to any increase in the corporation tax on the ground that this ought to carry with it an exemption from local taxation, as in Pennsylvania—a plan which they think unwise. They oppose a tax on corporate bonds for various reasons, and object to "local option," because they believe that it simply means taxation of realty alone.

The report of the legislative committee is more radical. They agree in opposing the income tax and the principle of local option. But they maintain that the taxation of savings-bank deposits is undesirable; that the equalization of taxes on personalty would "legalize a system of official guessing," and only intensify the conflict between the local divisions; but that a state tax on mortgages would be acceptable. They propose certain changes in the inheritance and corporation taxes and commend the separation of state and local revenues.

We come now to what is perhaps the best of the reports of this period—that of Ohio.[3] Most of the theories advanced are in accord with the sounder views, and everywhere an endeavor is made to conform to the necessities of practical reform. The commission tell us that the "tax-inquisitor" law produces less than two per cent of the taxes; while intangible property altogether pays only nine and four-tenths per cent of the state taxes, costing in some of the counties thirty-four per cent to collect. They maintain, however, that as the only just principle of taxation is that of contribution according to ability, an effort must be made to reach intangible personalty

[1] *Report of the Joint Committee of the Senate and Assembly relative to Taxation for State and Local Purposes*, New York, 1893, 602 pp.

[2] *Report of Counsel to revise the Tax Laws of the State of New York*, Albany, 1893, 125 pp.

[3] *Report of the Tax Commission of Ohio*, Cleveland, 1893, 77 pp.

in some other way. In a well-devised system taxation must on the whole be proportional to income or earnings, and yet the direct income tax they think virtually impossible as a state tax. Hence the necessity of getting at the income indirectly. Their solution of the problem may be summed up in a few words: taxation of real estate and tangible personalty; an inheritance tax, increased and extended; a franchise tax on the earning capacity of corporations and business enterprises; and the beginnings of a system of business taxes, through a tax on transfers of property, on law proceedings, etc. Altogether, the report of the Ohio commission is one of the most cheering evidences of the growth of saner and more enlightened views on the subject of taxation.

The next report is that of the Massachusetts commission of 1894.[1] Although it contains a few good suggestions, it discloses little acquaintance with modern views, and is distinctly inferior in this respect to that of the Ohio commission. The final recommendation is nothing more nor less than the introduction of the listing system. This is the sorry outcome of a long inquiry. On the other hand, the commission oppose the single-tax theory and advocate a graduated inheritance tax. This was fortunately the only proposal subsequently enacted into law. Three years later another Massachusetts commission made a report which was a distinct improvement.[2] Like the Maryland report of 1888, it shows the advantages of having a trained economist on the commission; for in this case Professor Taussig was doubtless largely responsible for the well-considered series of recommendations. The report is divided into three parts. The first gives an account of the existing tax laws. The second which describes the actual workings of the system, discusses, among other questions, that of the taxation of mortgages. The commission declare themselves satisfied with the situation. In the discussion of the tax on personal property they show that the classes most regularly and unfailingly taxed are live stock in the farming towns and ships and vessels. As regards the farming towns, the commission conclude that the method of taxing both real estate and tangible personalty

[1] *A Full Report of the Joint Special Committee on Taxation*, Boston, 1894, 109 pp.

[2] *Report of the Commission appointed to inquire into the Expediency of revising and amending the Laws of the Commonwealth (of Massachusetts) relating to Taxation*, Boston, 1897, viii., 322 pp.

probably works better than would a method of taxing realty alone. The commission also defend the tax on stock in trade as giving some clew to relative tax-paying abilities. Furthermore, they look forward to the time, when it may be possible to exempt machinery. The taxation of intangible personalty they declare to be in a high degree unsatisfactory. The third part of the report contains the recommendations. The commission propose that all securities representing interest in property outside of the state be exempted from taxation. The question then arises as to the substitute. The income tax is brushed aside as inexpedient. The Pennsylvania and Connecticut methods are discussed, but not recommended. Instead, the two new taxes suggested are an inheritance tax, and a habitation tax.

These are the chief points of the report, which represents an earnest effort to grapple with the difficulties. Although it had little success in shaping legislation, it is one of the clearest and strongest papers presented up to that time by any American tax commission.

The intervening years are marked by seven minor reports. Three of these are municipal. The city of Chattanooga recommended a permanent tax commission.[1] Cleveland made two reports in which Mr. Angell, the moving spirit of the Ohio report of 1893, repeated his arguments against the tax-inquisitor law.[2] The New Jersey commission made a report on railway taxation, in which it recommended a relinquishment of the second-class property tax to the localities.[3] Finally, the growing interest manifested in the subject is attested by three reports of the Illinois and the Connecticut Bureau of Labor Statistics, devoted entirely to taxation.[4]

Most of the reports thus far discussed were those of Eastern states. It is significant that toward the close of the century

[1] *Report of the Committee of the Chamber of Commerce of Chattanooga, Tennessee, on Assessments and Taxation*, Chattanooga, 1895, 22 pp.

[2] *The Cleveland Chamber of Commerce, Taxation, Report of Special Committee*, 1895, 22 pp.; *Taxation. Report of Special Committee*, Cleveland, 1896, 4 pp.

[3] *Report of the Commission to investigatce the subject of Taxation*, Trenton, 1897, 130 pp.

[4] *Eighth Biennial Report of the Bureau of Labor Statistics of Illinois*, Springfield, 1894, 2d ed., 1896; *Twelfth Annual Report of the Bureau of Labor Statistics of the State of Connecticut*, Meriden, 1896; *Ninth Biennial Report of the Bureau of Labor Statistics of Illinois. Subject, Franchises and Taxation*, Springfield, 1897.

the discontent now spread to certain parts of the West and of the South. The Wisconsin commission[1] apologize for their unsatisfactory conclusions, on the ground that the time and the means at their disposal were insufficient to enable them to elaborate any general plan of revision. The report contains a good account of the origin and growth of the tax system, an analysis and criticism of present methods, and some sensible remarks as to wide-reaching reforms. For the first time in any of the Western states the commission express doubt as to the wisdom of the general property tax. Yet they shrink from recommending any radical changes, for the reason that, "the great majority of the people are still so much attached to the general property system that suggestions or discussions of radical changes would not be acted upon or considered."

This conclusion is quoted in the report of the Texas commission,[2] which appeared a few months later. The Texas commission was by no means so able or so well acquainted with the literature of the subject as that of Wisconsin, and its activity was limited by the provisions of the act which made it its duty, "to frame a bill or bills calculated to secure an exhaustive and equitable assessment of every species of property." As a consequence, the report only slightly considers any changes which would impair the principle of the general property tax. The commission search in vain for any changes in the existing method which hold forth prospect of success. On the other hand the report of the Georgia commission of the same year was so radical that it failed of consideration by the legislature and so voluminous that it never saw the light in printed form.

The joint committee of New York[3] after considering alternative propositions for an increase of much needed revenue, finally recommended a tax on mortgages. They proposed to abolish the law which provided for the taxation of mortgages as a part of personal property both for state and for local purposes, and to substitute a tax of one-half of one per cent, to be levied only for state purposes. It was estimated that this would yield about $10,000,000. The proposition gave rise

[1] *Report of the Wisconsin State Tax Commission*, 1898, Madison, 1898.—276 pp.

[2] *Report of the Tax Commission created by Act of March 1, 1899, to inquire into the System of Laws and Regulations now in Force affecting the raising of Public Revenue, etc.*, Austin, 1899.—403 pp.

[3] *Report to the Legislature of New York by the Joint Committee on Taxation*, January 15, 1900.—26 pp.

to a heated debate. The unintelligent advocates, who believe that a tax will always rest at the point of original impact, supported the proposition on the general theory of hitting the wealthy who now escape. The unintelligent opponents sought to show that it would be a burden on the poor man, because he puts his accumulations in the savings banks which are virtually limited in their investments to mortgages on New York realty. The real-estate brokers although divided believed that the new tax would interfere with their business and therefore joined the opposition. In the end the bill failed of passage.

The problem of mortgage taxation was also made the subject of a Vermont report in the same year.[1] The committee, after considering the subject from every point of view recommended that mortgages bearing a rate of interest not exceeding 4½% should be exempted from taxation. Any possible decrease in revenue would, in their opinion, be more than compensated by a slight increase in the corporation taxes.

This concludes the reports of the period. Everywhere, it has been seen, the inadequacy of the general property tax was being realized; but a way out of the difficulties was not yet clearly perceived. It was reserved for the next period to throw some real light on the topic and to prepare the way for constructive recommendations.

III. *The Period 1901–1910*

We have thus far considered the reports of tax commissions up to 1900. In the new century we find not only a great increase in the activity of such special commissions, but also the appearance of periodical reports by permanent tax commissions. These, it is true, were not entirely absent from the early history of state finance. Massachusetts had created the office of State Tax Commissioner in 1865, Maryland in 1878, and Vermont in 1882,—all of them designed primarily to assess certain corporation taxes. In 1891 New Jersey initiated a State Board of Taxation and Indiana a State Board of Tax Commissioners, each of which was invested with more important duties than the ordinary boards of equalization; and in 1896 New York followed with a similar State Board. All of these officials or boards published annual reports which were largely formal in

[1] *Double Taxation in Vermont. Report of the Special Committee appointed to report a Measure for its Relief to the Legislature of 1900*, Burlington, 1900.—44 pp.

character. With the beginning of the new century, however, we note the development of permanent commissions with much broader powers, and in whose annual or biennial reports we now find the tax problems discussed from a wider outlook. The first report was that of Wisconsin in 1900, followed by that of Michigan in 1901. By 1910 nine such commissions were in existence and during the next eleven years twenty-five more states followed.[1] On the other hand, the Idaho commission was abolished in 1915, the Florida commission in 1918, and the Wyoming commissioner in 1919.

In most cases they were called simply the State Tax Commission. In a few states they were known by other names: in three [2] they were called the State Board of Tax Commissioners or Board of State Tax Commissioners; in seven [3] State Tax Commissioner; in one [4] the State Board of Taxes and Assessments; in one [5] Commissioner of Corporations and Taxation; in one [6] Board of State Assessors; and in one [7] the State School Tax Commissioner.

Of these permanent tax commissions, the Wisconsin and the Minnesota reports have been easily the most important. Worthy of note also have been those of Washington, West Virginia and Michigan, and, in more recent years, those of Connecticut, Rhode Island and New York. We may, however, omit any further treatment of this phase of the subject as it has now been fully discussed in a recent publication.[8]

[1] We append a list of states with permanent commissions with the date of appearance of the first report: 1900, Wisconsin; 1901, Michigan; 1902, Connecticut, North Carolina; 1906, West Virginia, Washington, Texas; 1907, Alabama; 1908, Minnesota; 1909, Kansas; 1910, Ohio, Wyoming; 1911, New Hampshire, Oregon; 1912, Arizona, Arkansas, Colorado, North Dakota, Rhode Island; 1914, Florida, Georgia, Idaho, Montana, Nevada, South Dakota; 1915, Maryland, New Jersey, South Carolina; 1916, New Mexico, New York, Mississippi; 1918, Kentucky, Missouri; 1920, Massacusetts; 1921, Delaware.

[2] Indiana, Michigan, and Rhode Island.

[3] Connecticut, Georgia, Montana, North Dakota (since 1919), Texas, Washington (since 1917) and West Virginia.

[4] New Jersey.

[5] Massachusetts.

[6] Vermont.

[7] Delaware. So called because the proceeds of new personal income tax and general corporation tax are to be devoted to school purposes.

[8] Harley L. Lutz, *The State Tax Commission. A Study of the Development and Results of State Control over the Assessment of Property for Taxation*, Cambridge, 1918.—671 pp.

Before we take up the special commission reports of this period, it will be well to devote a word to the proceedings of an unofficial convention, which did its share in helping to arouse general interest in the subject. We refer to the National Conference on Taxation at Buffalo.[1] The conference was attended not only by students of the problem, but by men engaged in the administration of the revenue laws, as well as by representatives of the important interests subject to taxation. As a consequence, the papers were varied and interesting; and the proceedings were enlivened by an active discussion. Papers on general topics were read by such men as Senators Garfield of Ohio and Bucklin of Colorado, Mr. Judson of Missouri, Mr. Seward and Mr. Purdy of New York, and Judge Howard of Indiana. The academic element was represented by Professor Henry C. Adams, Dr. Max West, Dr. R. H. Whitten, Professor Bemis, the author of this volume, and others. The bankers were represented by Hon. C. S. Fairchild; the railways, by Mr. Davies and Mr. Hines; the insurance companies, by Mr. Hoffman and Mr. Fryer; and the farmers, by Mr. Creasy of the Pennsylvania State Grange. The conference adopted resolutions in favor of the avoidance of double taxation and looking to co-operation among the states. Provision was also made for the appointment of an executive committee, to whom should be intrusted the arrangements for the development of a permanent organization.

The first tax commissions to report in the new century were those of Colorado and Kansas. Senator Bucklin was responsible for the Colorado report, which attracted attention because of its advocacy of the taxation of land values.[2] The commission opposed the inheritance tax and had practically nothing to say of the corporation tax. But to the extent that they recommended a constitutional amendment, relaxing the rigid provisions on taxation, they secured the support even of those who were not prepared to go to the length of accepting their entire plan.

At the Buffalo conference the officials of Indiana advanced the claim that their system was far superior to that in the other states. The Kansas commission [3] were so much im-

[1] *National Conference on Taxation, under the auspices of the National Civic Federation. Held at Buffalo, New York, May 23 and 24, 1901.*—185 pp.

[2] *Report of the Revenue Commission of Colorado,* Denver, 1901.—62 pp.

[3] *Report and Bill of the Kansas State Tax Commission,* Topeka, 1901. —113 pp.

pressed by this contention that they decided to recommend the adoption of the Indiana method of taxing corporations. While the commission still cling to the general property tax, some of the discussions at Buffalo, especially those relating to the taxation of mortgages, evidently bore fruit; for the commission tell us that this "is another illustration of that curious shifting of the burden of taxation, which we are just beginning to understand."

The report of the West Virginia commission [1] shows unmistakably that they profited by the Buffalo Conference. The preliminary report contents itself with putting the recommendations for and against changes in the methods of taxation in a fair and lucid way. In the final report [2] the commission maintain that the best plan is to abandon the attempt to assess intangible personal property. They confess, however, that under the constitution, this is impracticable. While waiting for an amendment, they recommend that the system of deduction for debts be extended to intangible personalty, that mortgages be exempted, and that the separation of sources be introduced.

The Vermont report [3] confines its attention to the discussion of corporations and the grand list. The volume contains a concise history of the tax on each kind of corporation, with a recommendation to introduce a progressive rate into the earnings tax. The grand list is declared to be in a very unsatisfactory condition, not representing by any means the true cash value of either real or personal property. This statement, however, is followed as an anticlimax by the recommendation of a board of equalization as a remedy. It is evident that the economic conditions in Vermont were not yet those of a developed industrial state.

The Minnesota commission [4] tell us that in "passing to the assessment of personal property, we enter a field of confusion

[1] *Preliminary Report of the West Virginia State Tax Commission*, 1902. Charleston—45 pp.

[2] *Preliminary and Final Report of the West Virginia State Taxation Commission, 1902.* Charleston—78 pp.

[3] *Special Report of the General Assembly (of Vermont), 1902, relating to Taxation of Corporations and Individuals. By the Commissioner of State Taxes.* Burlington, 1902.—134 pp.

[4] *Report of the Tax Commission of Minnesota created by Chapter 13, General Laws of 1901, for the purpose of framing a Tax Code.* St. Paul, 1902.—223 pp.

worse confounded." Their recommendation is a half-hearted proposal of the listing system. They suggest, however, the separation of state and local revenues and have something to say about an inheritance tax. The one striking proposal in the report is the suggestion of an income tax.

The Missouri report [1] is a modest one. The commission hold that the defects of the general property tax may be corrected by requiring the assessor to put into separate columns actual and taxable values. If, however, this does not accomplish the results anticipated, "it certainly can be no worse in practice than the system now in vogue." The existing system is so bad, we are told, that any attempt to present statistics on the subject would be useless. Missouri, also, it is clear, had not quite reached the point where it was ready to face the real difficulties of the problem.

The report of the New Jersey commission [2] of 1905 deals almost exclusively with railways. They recommend that the rate on the main-stem property be increased and that the second-class property, although still assessed by the state board, be taxed at the full local rate for the benefit of the localities. Their recommendation was adopted by the so-called Duffield act of 1905. But this did not satisfy public opinion, and in 1906 the system was again changed in several respects.[3]

The conditions in Ontario, Canada, were so similar to those obtaining in our states that the problems of taxation were closely analogous. The commission appointed to consider the railroad taxation accordingly made a study of the situation in the United States. The report [4] (which, it is understood, was written by Professor Short) is an able presentation of the subject, giving a survey of the various systems employed and concluding that the best method is to tax railroads on gross receipts.

The Oregon report [5] devoted its attention to the plan whereby

[1] *Report of the State Tax Commission of Missouri, 1903.* Jefferson City. —35 pp.

[2] *Report of the Commissioners appointed to investigate the Subject of Taxation in New Jersey.* Trenton, 1905.—170 pp.

[3] *Cf. supra*, p. 174.

[4] *Report of the Ontario Commission on Railway Taxation, 1905.* Toronto, 1905.—219 pp.

[5] *Report of the Board of Commissioners appointed under the Provisions of chapter 90, law of 1905, for the purpose of examining and reporting on Matters of Assessment and Taxation.* Salem, 1906.—332 pp.

state expenditures were to be defrayed by contributions imposed upon the counties in proportion to local expenditures instead of local valuations. This project was, indeed, not carried out, for reasons that have been mentioned elsewhere.[1] The commission conclude that it is impossible to reach personalty by the present method of taxation and suggest that personalty should be reached by a system of state taxes on corporations.

The California commission was fortunate in securing as secretary Professor Plehn, who is described in the report as an "expert on taxation and public finance." This resulted in a report which is one of the best proportioned documents that have yet emanated from any of our states. The commission issued a preliminary report [2] submitting its tentative recommendations to criticism. The final report [3] contains some not unimportant alterations, and shows the inequalities in the assessment of real estate and the failure to reach personalty. The commission think that the first step in reform is to bring about a separation of the sources which they propose to accomplish by securing the state revenue from taxes on corporations. They take up in turn the various classes of corporations and discuss the principles involved in the taxation of each class. In fact the report may be declared to be a treatise on the taxation of corporations. They suggest, as to railways, the tax on gross earnings in preference to the Michigan-Wisconsin *ad valorem* plan. When the constitutional amendment suggested by the commission was defeated in 1908 they proceeded to prepare a new amendment, providing for a complete separation of state and local revenues, the state revenues to be derived from taxes on the gross receipts of corporations, together with taxes on banks, and franchises in general. They again called attention to the defects of the general property tax, the real meaning of separation, and the objects of the new scheme.[4] The commission made out so good a case that the amendment was adopted in 1910.[5]

[1] *Cf. supra*, p. 363.

[2] *Preliminary Report of the Commission on Revenue and Taxation of the State of California, August, 1906*. Sacramento, 1906.—71 pp.

[3] *Report of the Commission on Revenue and Taxation of the State of California, 1906*. Sacramento, 1906.—296 pp.

[4] *Report of the Commission on Revenue and Taxation*. Sacramento, 1910. —77 pp.

[5] *Cf. supra*, p. 372.

The Missouri commission [1] were a unit in agreeing that the first step in tax reform is a separation of the sources. They therefore discussed this proposition only, showing its advantages and recommending the adoption of a constitutional amendment to render such a separation possible. In accordance with this recommendation, a bill proposing a constitutional amendment, which provided for the possibility of local option in taxation, was introduced into the legislature, and was subsequently enacted into law.

The Massachusetts committee [2] apart from two brief passages, in which they suggest the broadening of the collateral into a direct inheritance tax and the imposition of a tax on the transfer of stocks, devote their report to the taxation of corporations. In the treatment of this subject the committee must be regarded as a continuation of the committee on corporation laws of 1902. The report of that committee led to the law of 1903, which split the corporation tax into three parts, dealing separately with street railways companies, other public-service corporations, and commercial and manufacturing corporations in general. The system of taxing the "corporate excess," as it was called, had given rise to much discontent. The new committee content themselves with minor suggestions for the reason that in their opinion "the method now in operation in Massachusetts in superior to the methods in operation in the largest and most progressive of the other states." Two minority reports, one on the taxation of intangible personalty, the other on the general tax system, dissent from these conclusions.

The report of the New York tax commission [3] of which the writer was a member, seeks to attack fundamental problems. New York had by this time almost reached the separation of state and local revenues. The first series of questions discussed in the report pertain to the state revenue. While two of the state taxes—those on inheritances and on corporations—existed in a few other commonwealths, New York possessed other

[1] *Special Message of Governor Joseph W. Folk, concerning Reform in Taxation, including a Report of the Tax Commission, January 17, 1907.* Jefferson City, 1907.—11 pp.

[2] *Report of the Joint Special Committee on Taxation, appointed to consider the Expediency of Legislation in amendment of or in addition to the General Laws relating to Taxation, January, 1907.* Boston, 1907.—136 pp.

[3] *Report of the Special Tax Commission of the State of New York, transmitted to the Legislature, January 15, 1907.* Albany, 1907.—189 pp.

taxes of importance like the liquor-license, the mortgage-recording tax, and the stock-exchange tax. The stock-exchange tax is discussed in the light of a proposition to extend it to produce and other exchanges. The fullest treatment is accorded to the inheritance tax. The commission recommend the adoption of a system of graduation with rates considerably higher than exist anywhere else. The three fundamental problems are declared to be the relation of state and national taxation; the relations of state and local taxation; and the reform of local taxation. As regards the first point, the commission discuss the situation in the light of the utterances of President Roosevelt, recommending national income and inheritance taxes. Opposition is shown to the suggestion of a federal inheritance tax on the ground that it would deprive the states of one of the chief means of securing tax reform. Attention is also called to the growing evils of double taxation arising from interstate complications. The commission recommend the creation of a permanent body to deal with such problems.

When they approach the relation of state and local revenues the commission distinguish between the separation of source and the division of yield,[1] suggesting that the state levy high taxes on special kinds of property or business and turn over some of the surplus to the localities. The final point to which the commission addressed themselves was the reform of local taxation. Here the commission were unable to agree, although they did unite in a scathing arraignment of the present system. A supplementary report recommends a more rigorous enforcement of the existing law. A second supplementary report proposes an income tax; while the third argues against both of the preceding suggestions and recommends the adoption of a local-option scheme in order to replace the personal property tax by a graduated habitation tax.

In the following year 1908 no less than six reports appeared. The first was that of Massachusetts.[2] The report of the committee of 1907[3] had been so inadequate that the new commission was given a broad scope. After discussing

[1] *Cf. supra*, p. 365.

[2] *Report of the Commission on Taxation to investigate the Subject of Taxation and to codify, revise and amend the Laws relating thereto.* Boston, 1908. —234 pp.

[3] *Cf. supra*, p. 615.

some questions connected with the distribution of the corporation tax, the commission deal with the personal property tax. Statistics are presented to show the breakdown of this system in Massachusetts and elsewhere. The proposed remedy is the adoption of the Baltimore plan of taxing securities at a low flat rate. Accordingly they recommend a constitutional amendment to permit classification, and also urge an increase in the powers of the state tax commissioner over local assessors.

The Ohio commission [1] present an outline of the existing system, including the Nichols, the Willis, and the Cole laws applying to corporations. The chief inequalities which they discuss are those among owners of real estate; among owners of personal property; between individuals and corporations; and among corporations. Their principal recommendations are a constitutional amendment to permit classification; the establishment of a state tax board; a more frequent appraisement of real estate; the separation of state and local revenues; and publicity in taxation. A few years later some of their recommendations were adopted. A state tax commission was established, the decennial real estate assessment was changed to a quadrennial assessment, and provision was made for sending to each taxpayer a printed copy of the real estate roll.

Shortly thereafter followed the report of the Louisiana committee.[2] They were forced, we are told, to the conclusion that "a general property tax system, based on a constitutional requirement of equality and uniformity, is vicious and leads to the grossest inequalities and injustice." They therefore recommend a constitutional amendment to permit classification; the separation of state from local taxation, which they consider a "fundamental principle"; the creation of a permanent tax commission; the exemption of mortgages; the imposition of a true inheritance tax; the taxation of salt, sulphur, petroleum and gas mines, according to gross product; the separate assessment of land and improvements; a corporate franchise tax; and a cotton-future stamp tax. Finally, they oppose the existing license taxes. Three concurring reports are made by individual members; one on home rule in taxation; another on the taxation

[1] *Report of the Honorary Commission appointed by the Governor to investigate the Tax System of Ohio and recommend Improvements therein.* Columbus, 1908. This report appeared in two versions, one of 62 pp., including a letter of the Governor, and one of 64 pp., without this letter.

[2] *Report of the Tax Commission of Louisiana.* Baton Rouge, 1908.—36 pp.

of mortgages; and a third on the necessity of the constitutional amendment. It would be difficult to find in any other recent report so much valuable information packed into so little compass.

Toward the end of the year appeared the reports of three more New England states. The Vermont commission [1] begin by asserting: "undoubtedly there is in the state a widespread belief that there is something radically wrong with our present system of taxation." They declare, however, that any drastic change in the system should be attempted only after a more thorough investigation. Their chief recommendations comprise: a tax commission; the separate appraisal of land and buildings; the abolition of the power to offset debts; a direct inheritance tax; the abandonment of the distinction in the treatment of shares of domestic and foreign corporations; and the reduction of the savings bank tax. One-half of the commission also recommend the adoption of the Baltimore plan. A minority object to the flat-rate plan, and recommend a graduated income tax.

The Maine commission [2] tell us that listing laws are a failure. They consider the question of separation of state and local revenues, but conclude that, notwithstanding its advantages, "to raise all our revenue by taxing franchises would tend to extravagant legislation." They prefer a taxation of corporations on the *ad valorem* basis; and suggest an inheritance tax, a reduction of the bank tax, and an abolition of the retaliatory provisions in the insurance taxes. They welcome the adoption of the Baltimore plan for the taxation of mortgages, and warmly espouse the creation of a permanent tax commission. Finally, they pay some attention to the legal problems connected with the assessment of wild lands and refuse to recommend a stumpage tax on timber lands.

The New Hampshire report consists of two bulky volumes—the report proper and an appendix, which comprises all the tax laws from 1641 to the present. [3] The commission point out that "virtually no regard whatever is paid to the law requiring sworn inventories to be returned to the assessors." Their

[1] *Report of the Commission on Taxation of the State of Vermont.* Montpelier, 1908.—115 pp.

[2] *Report of the Maine Tax Commission.* Waterville, 1908.—91 pp.

[3] *Report of New Hampshire Tax Commission of 1908.* Concord, 1908.—326 pp. *Appendix to Report of Tax Commission of 1908. Taxation in New Hampshire.* Concord, 1908.—300 pp.

language is not always courteous, as when they quote an ex-governor of West Virginia as asserting "that the tax laws of Ohio are the most imbecile and jackassical of any in the country." They do not like the Baltimore plan because "in spite of the temptation to be honest held out to the citizens of Maryland, a good proportion of the intangible property taxes is a figment of the assessors. If they are to guess at all, it might as well be for the larger rate as for the smaller." They recommend the separation of state and local revenues and the exemption of money and credits. They propose a direct inheritance tax; take exception to the Massachusetts plan of taxing corporations; and suggest a tax based upon a capitalization of net income. The poll tax, they think, ought to be reformed by being made a fixed tax instead of being treated as a part of the property tax. Finally, a strong argument is made for a permanent tax commission. A separate report on railway taxation is written by one of the commissioners, discussing in detail the various methods utilized in the United States.

It will perhaps not be amiss to join to the reports of the preceding states that of the Hawaii commission.[1] The problems of Hawaii are, of course, very different from those existing on the continent, for as the commission point out, "industrial life is not complicated as yet; and it is not easy to evade taxes on personalty nor difficult to find the property itself." The real problems of Hawaii are those of the real estate tax, of the "enterprise-for-profit" tax, and of the income tax. The commission recommend an assessment of real estate for three years; and the abolition of the eight-year rental system, whereby the selling value of houses is estimated at eight times their actual rental value. On the other hand, they do not recommend the abolition of the tax on growing crops, nor of the enterprise-for-profits tax. Finally, the commission suggest certain amendments in the inheritance tax and uphold the poll tax. The report is interesting as showing the influence of economic environment upon fiscal systems.

In 1909, we find three reports. The Delaware commission [2] call attention to the fact that the state has a system of separation in force. But the dissatisfaction is still pronounced. In the

[1] *Report of the Tax Commission to the Governor of Hawaii,* June 30, 1908. Honolulu, 1908.—87 pp.

[2] *Report of State Revenue and Taxation Commission of the Joint Assembly of the State of Delaware,* January 5, 1909. Dover.—83 pp.

first place, the state business and occupation taxes are entirely too crude. The commission suggest in their stead the Ontario business assessments. They also recommend an inheritance tax, an increase of the license tax, and the securing of revenue from the oyster beds. In theory they believe the fairest tax would be that upon incomes but are dubious about its practicability. Finally, they propose the creation of a permanent tax board. A series of appendices gives a history of taxation in Delaware and a survey of the existing laws. In their final report of the next year [1] they content themselves with repeating most of their previous recommendations.

The Kentucky commission [2] was divided into two groups: the Advisory Commission, to make recommendations, and the Tax Commission, to frame legislation. The commission as a whole reported that the Kentucky system is inadequate for four reasons: "First, it does not produce sufficient revenue; second, it places an undue portion of the public burden on some classes of property; third, it has resulted in driving and keeping from the state a large amount of capital; fourth, it produces evasion, dishonesty and perjury, encourages contempt for the law and lowers the moral standard of our people." The recommendations are a constitutional amendment permitting classification; a permanent tax commission with large powers; and the separation of state and local revenues.

On a preceding page [3] we called attention to the report of the Massachusetts commission of 1908. The Supreme Court was asked whether the proposed three-mill tax would be constitutional; and when they reported in the negative, the General Court agreed to a constitutional amendment to permit such classification. Thereupon a special commission was appointed to consider the question and the arguments on either side were summed up by Professor Bullock [4] and Mr. Matthews.[5] After

[1] *Report of the Delaware State Revenue and Taxation Commission.* Dover, 1910.—13 pp.

[2] *Tax Revision, State of Kentucky, Tax Commission, Advisory Commission.* Frankfort, 1909.—45 pp.

[3] *Supra*, p. 616.

[4] *Argument in Favor of the Proposed Constitutional Amendment permitting the General Court to classify Property for the Purposes of Taxation.* By Charles J. Bullock for the Taxation Committee, Boston Chamber of Commerce, October 26, 1909.—58 pp.

[5] *The Proposed Amendment for the State Constitution. Argument of the Remonstrants.* By Nathan Matthews, Boston, 1909.

an examination of the arguments adduced by Professor Bullock and his associates the commission conclude against the proposition.[1] They contend that "whatever the shortcomings of the present system may be, the evils likely to be produced by the proposed remedy would be far worse." These objections they sum up as follows: first, the three-mill tax would cause economic disturbance by unsettling values and encouraging capital to seek foreign investment; second, it would cause financial disturbance by reducing revenues; third, the power of classification might be used to introduce a multitude of special taxes with various rates, thus threatening the stability of values; fourth, the desire to secure legislative favor, in the form of reduced taxation would produce constant agitation; fifth, the passage of the amendment would open the door to the enactment of unjust, discriminating measures, designed to penalize wealth. This report was sufficient to kill the movement for classification.

IV. *Municipal Tax Commissions*

Before we proceed to the last period of state tax reports, it may be profitable to say a few words about the municipal reports. The municipal reports on taxation are of comparatively recent date. The early reports [2] have been referred to above. By the opening of the twentieth century, however, the question of taxation in our large cities assumed important dimensions. In Chicago, the committee on public affairs of the City Club selected the municipal revenue system as the most outstanding topic to be studied, and Professor Merriam was chosen to undertake the investigation. His report is one of interest and value.[3] It is divided into four parts, treating respectively of the development of the Chicago revenue system since 1871; of the revenue systems of American and foreign cities; of the present revenues of Chicago; and of some general questions of reform. The report is clear, succinct and suggestive, not only containing an acute analysis of present evils, but also disclosing a familiarity with modern literature. The field

[1] *Report of the Commission appointed under the Provisions of Chapter 142 of the Resolves of 1909, to investigate the Laws relating to Taxation.* Boston, 1909.—80 pp.

[2] *Supra*, pp. 597 and 607.

[3] *Report of the Investigation of the Municipal Revenues of Chicago.* By Charles Edward Merriam. Chicago City Club, 1906.—161 pp.

covered is so broad that it would be impossible to make any intelligent comments without virtually writing a treatise on public finance. Suffice it to say that this report gives not only an admirable systematic survey of conditions as they exist but also interesting suggestions for improvement.

In New York the situation was somewhat better than in Chicago because of differences both in the law and in the administration. But here also many complex questions led to the appointment, in 1905, of an advisory commission on taxation and finance. The commission was divided into three committees. The committee on taxation and revenue made a number of reports.[1] Among them is a statistical study of the municipal revenues of London, Paris and Berlin, as well as a report on uncollectible taxes and the abuses that have arisen in connection with the issue of corporate stock, for arrears of taxation. The recommendations of the committee were subsequently enacted into law. The chief reports deal with the administration of the personal property tax, which is shown to be a complete farce. A little later in the year the other committees on the city debt and on the system of accounts and statistics made their reports.[2]

It was found impossible, on account of New York's enormous debt, to proceed with the rapid transit schemes, as the constitution limited the debt to ten per cent of the assessed valuation of real estate. A considerable part of the debt was, however, only nominal, as the income from water rates, dock rents, and subway leases were more than sufficient to pay the interest. The commission therefore proposed a constitutional amendment which, while exempting from the terms of the limitation bonds issued for self-supporting enterprises, would provide a

[1] *Advisory Commission on Taxation and Finance, Committee on Taxation and Revenue; Reports submitted at meeting of May 9, 1905* (New York, 1905. —43 pp.); *Report of Mr. Purdy on the Personal Property Tax*, 1905 (New York, 1905.—31 pp.); *Report of Commmittee on Taxation and Revenue, December, 1905* (New York, 1905.—37 pp.); *Report of Committee on Taxation and Revenue on Personal Property Taxation, 1907* (New York, 1907.— 9 pp.).

[2] *Advisory Commission on Taxation and Finance. Report on the City Debt in its Relation to the Constitutional Limit of Indebtedness. Containing a Proposed Amendment to Section 10 of Article VIII. of the State Constitution,* April, 1907.—14 pp. *Report on the System of Accounts and Statistics of the City of New York*, June, 1907.—25 pp. *Report of Committee on Taxation, and Revenue on Collection of Arrears of Real Estate Raxes and Assessments,* Dec., 1907.—33 pp.

nearly automatic plan whereby, should such an enterprise ever become non-supporting, the bonds issued to defray its cost would immediately be counted in estimating the debt. The report on the collection of arrears called attention to the inadequacy of existing methods and suggested as a remedy the creation of tax liens. This suggestion, also, like the preceding one in reference to the debt, soon became law.[1] The report on statistics and accounts was not so far-reaching, but some of the suggestions were taken up independently by the Bureau of Municipal Research, which subsequently succeeded in revolutionizing the budgetary procedure and the city's method of accounting. In 1908 the commission made its final report,[2] in which it recounted what had been accomplished.

Unofficial aid in the study of New York tax problems was rendered by the Chamber of Commerce, through its committee on state and municipal taxation. Beginning with the new century, there appeared in rapid succession in scarcely more than a year five reports prepared under the chairmanship of the Hon. G. H. Seward.[3] They contain an account of the existing system of taxation in New York but are not quite in harmony with the plan of Governor Odell, who was at the time seeking to realize the project of an independent source of revenue for state purposes. During the next few years the topic uppermost in public discussion was the taxation of mortgages. We find accordingly several reports devoted to this subject.[4] In the preceding pages [5] we called attention to the proposal of the committee of 1900. After long agitation, a law was enacted

[1] The tax-lien law was enacted in 1908; the constitutional amendment affecting the debt limit was adopted in 1909.

[2] *Advisory Commission and Finance.* Final Report, October, 1908.—161 pp.

[3] *Report of the Committee on State and Municipal Taxation of the Chamber of Commerce of the City of New York. Submitted October 4, 1900.* New York, 1900.—36 pp. Do. *Submitted December 20, 1900.*—12 pp. Do. *Submitted January 3, 1901.*—12 pp. Do. *Submitted May 2, 1901.*—14 pp. Do. *Submitted December 5, 1901.*—4 pp.

[4] *Reports of the Committee on State and Municipal Taxation of the Chamber of Commerce of the State of New York: Report on the Stranahan Mortgage Record Tax*, 1902; *Report on the Corporation Tax Bill*, 1902; *Report on a Plan for reducing Taxation*, 1902; *Report on the Taxation of Mortgages*, 1902; *Report on the Taxation of Mortgages*, 1903; *Report on the System of Taxation of New York*, 1903; *Report on the Taxation of Mortgages*, 1904; *Report on Tax Measures pending in the Legislature*, 1905; *Report on the Taxation of Mortgages*, 1906.

[5] *Supra*, p. 608.

in 1905, exempting mortgages from the property tax, assessing them at a special low flat-rate property tax, and providing for an adequate enforcement of the new measure. This led to such an agitation that, in 1906, the annual tax was replaced by a recording tax. The reports of the committee of the Chamber of Commerce helped to bring about this result.

Of perhaps more influence in securing the repeal of the annual mortgage tax was a report published by the New York Tax Reform Association, and prepared by the secretary, Mr. Lawson Purdy.[1] In order to settle the question, Mr. Purdy selected certain counties in New York and adjoining counties in Massachusetts, where mortgages have been exempted from taxation since 1881. He also chose certain counties in Pennsylvania where mortgages are taxed under a separate law. Statistical tables compiled from the mortgage records showed conclusively that in New York the liability to possible taxation under the old law (providing for a tax on mortgages as a part of the general property tax) increased the rate of interest by a mill and a half in some counties and by three or four mills in others and that the annual mortgage tax of 1905 increased the rate of interest by slightly more than the amount of the tax. It may be added that tables prepared after the repeal of the annual tax and the enforcement of the recording tax showed that the rate of interest had again proportionately fallen. This corroboration of the general theory led during the next few years to the adoption of the mortgage recording tax by other states.

One of the reports of the mayor's commission mentioned above contained a recommendation to abandon the remaining vestiges of the personal property tax in New York City. Mayor Gaynor had no sooner assumed office than he espoused the project. A committee of the Chamber of Commerce [2] felt constrained to oppose the law on the ground that it ought to be applied to the state as a whole. The committee of the

[1] *Mortgage Taxation and Interest Rates: Abstracts of Mortgage Records in certain counties of New York, Massachusetts and Pennsylvania, illustrating the Effect of the new annual Mortgage Tax Law.* New York Tax Reform Association, 1906.—19 pp.

[2] *Report of the Committee on State and Municipal Taxation of the Chamber of Commerce on the Bill to amend Section 4 of the Tax Law in Relation to the Exemption of Personal Property from Taxation.* May, 1910. This report is also printed in the *Monthly Bulletin*, vol. ii., no. 2, of the Chamber of Commerce, pp. 20–32.

Merchants' Association on the other hand favored the bill.[1] Although it failed of passage by a narrow majority, its object was accomplished in part by the enactment of the secured-debts law in the following year.[2]

While the taxation of personal property in New York had almost reached the vanishing point, the situation in Baltimore was slightly different. An advisory committee, of which Professor Hollander was chairman, was created in 1907.[3] The conditions which led to its appointment were declared to be the urgent need for increased revenues, the burdensome character of the direct property tax, and the inelasticity in the other sources of income. The committee recommended that additional revenues be secured by an increase in the liquor licenses, and by the taxation of the street franchises of public service corporations. The most interesting part of the report is that which deals with personal property. According to the so-called Baltimore plan, bonds or certificates of indebtedness and corporate shares other than those of Maryland companies are taxed at a flat rate of three mills. The adoption of this plan in 1897 resulted in the increase of assessments from about six millions in 1896 to over one hundred and fifty millions in 1907. This remarkable showing, however, by no means blinded the committee to the defects that still inhere in the system, for in 1907, in a population of 550,000 only 2,281 individuals were returned as owning securities.

On the other hand, the tax on tangible personalty worked far more badly, the taxable basis being actually less in 1908 than it was in 1898. In the same way we are told that the net assessment of shares of Maryland corporations owned in Baltimore fell from forty-one millions in 1900 to thirty-six millions in

[1] *Report of the Committee on Finance and Taxation of the Merchants' Association of the City of New York on the System of Personal Taxation,* March 26, 1910. This report was published in the Merchants' Association *Bulletin* and also separately.

[2] By "secured-debts" were meant all mortgages, bonds, debentures and notes forming part of a series that do not come under the mortgage-recording law. The payment once only of ½ of 1% on the face value of such securities exempted them from ordinary local assessment as personal property. If the state tax was not paid, the owner was liable to local assessment, without being allowed to deduct or offset his indebtedness as heretofore. Practically the law of 1911 was an extension of the mortgage-recording tax to all bonds and mortgages.

[3] *Report of the Advisory Committee on Taxation and Revenue submitted to the Mayor of Baltimore.* Baltimore, 1908.—152 pp.

1908. The committee therefore advocate the creation of a State Tax Commissioner and a better organization of the Appeal Tax Court. They take pains, however, to disclaim any "endeavor to drag the ponds or to go through Baltimore with a fine-tooth comb."

The Pittsburg report deserves only a word,[1] as it concerns itself with the question of classification of real estate. Pittsburg, as is well known, had retained the primitive classification into city, rural and agricultural property. The committee of 1910 found that this discrimination penalized the business interests and the small householder, and that it encouraged speculation. They accordingly opposed the whole system and recommended the introduction of a bill to abolish classification, and to provide for a uniform valuation as in other American cities. These recommendations became law in 1911.

Several years later, we find another Pittsburg report.[2] The early years of the second decade had witnessed a movement in favor of the exemption of improvements and in 1913 the so-called graded tax law was adopted, which provided for a reduction every two or three years of 10% of the assessed valution of improvements until in 1925 they should be assessed at only 50% of their value. The committee recommended a continuance of the system, but proposed also the abolition of the personal property tax and the institution of a graduated inheritance tax as well as of an income tax to be levied by the state with a share going to the city. To carry out such a program, a state tax commission was suggested.

In the meantime, Cleveland dealt with its embarrassing local situation. The report [3] saw the way out of the difficulties partly through a system of classification, partly through a mortgage recording tax, and partly through an independent state revenue from corporations, with permission to the cities to levy an additional increment tax on land values. By a bare majority of one, the rather numerous commission approved of a progressive inheritance tax and a local land-value tax.

[1] *Tax Property on Full Value. Recommendation for Legislation to abolish Present Classification of Property for Taxation Purposes. Report of Committee on Real Estate and Taxation, approved by Chamber of Commerce of Pittsburg,* November 10, 1910. Pittsburg, 1910.—7 pp.

[2] *Report of the Committee on Taxation Study to the Council, City of Pittsburgh,* 1916.—105 pp.

[3] *Report of the Special Tax Commission of the City of Cleveland,* 1915.—72 pp.

In San Francisco the problem of municipal finance was attacked from the expenditure side, the report of 1915 [1] declaring that the limit of taxation, assessed on the customary sources, had well-nigh been reached and suggesting a solution through budgetary reform and retrenchment. The administrative point of view is also apparent in the report of the Cambridge committee [2] which numbered among its members Professor Bullocks and Spofford. The committee recommend that the assessors be appointed rather than elected, that tax maps be prepared, and that a civil engineer be employed to prepare mathematical rules and tables.

The movement in favor of some additional burden on land values reached its climax in New York, where an active political program in favor of exemption of improvements led to the formation of the Committee on Taxation in 1914. As early as 1913 a special commission [3] had recommended the adoption of an "unearned increment" tax. Now in 1916 a much larger commission, of the executive committee of which the present writer was chairman, made an elaborate report [4] accompanied by three reports of experts.[5] The conclusion, which was decisively against the proposal to exempt improvements from taxation, put an effective quietus upon the movement, not only in New York, but throughout the country. As a result, the report of the next New York City commission,[6] which dealt in large measure with purely administrative problems, now recommended for an increase of city revenues a general income tax, an extension of the so-called Emerson law taxing corporations, and the introduction of certain special taxes.

[1] *California State Tax Association. The Problem of High Taxes in San Francisco.* San Francisco, 1915.—119 pp.

[2] *City of Cambridge, Massachusetts. Report of Special Committee on Study of the Local Real Estate Assessment Situation*, 1915.—14 pp.

[3] *Report of the Commission on new Sources of City Revenue, City of New York, submitted to the Mayor.* January 11th, 1913.—116 pp.

[4] *Final Report of the Committee on Taxation of the City of New York*, 1916. —398 pp.

[5] The three separate reports were *Excess Condemnation, Report of the Committee of Taxation of the City of New York, with a report prepared by Herbert E. Swan for the National Municipal League.* New York, 1915.—117 pp.; *The Exemption of Improvements from Taxation in Canada and the United States. A Report by Robert Murray Haig.* New York, 1915.—254 pp.; *Some Probable Effects of the Exemption of Improvements from Taxation in the City of New York. A Report by Robert Murray Haig.* New York, 1915.—254 pp.

[6] *Report of the Mayor's Advisory Commission on Administration of the Tax Law of New York*, 1917.—107 pp.

The last of the municipal reports of the period is that of Winnipeg.[1] The experiment with the so-called single tax in Canada having turned out rather disastrously, the board of valuation reported that it had now become necessary to diminish, rather than to augment, the burden on real estate. Their conclusions were summed up in a recommendation to convert the old business tax, which had been levied as a substitute for the personal property tax since 1893, into an income tax.

V. *The Period 1910–1921*

Reverting now to the special state tax commissions, we come to the last decade, which witnessed some notable changes in general attitude. The year 1910 opened with a series of reports from Rhode Island. The committee, finding conditions most unsatisfactory,[2] recommend the establishment of some form of effective state supervision; a classification of property with a low flat rate on certain forms of intangibles; a reform of the corporation tax law (Rhode Island being one of the few states which still clung to the primitive method of the general property tax as applied to corporations); provision for an independent state revenue from corporations, and inheritances; and a separate assessment of land and improvements. Two valuable appendices contain an account of the system of tax supervision and a survey of the corporation tax in the most important states. In their second report[3] of the following year the committee call attention to the fact "that the general property tax stands to-day discredited even more conclusively than a year ago." They had in the meantime investigated the workings of centralization in Wisconsin and Minnesota, and approve of it even more thoroughly than before. An appendix contains all the important changes in the tax laws of the various states during 1909 and 1910.

Somewhat later in the year the committee made another report[4] extending its recommendation for a tax on the cor-

[1] *City of Winnipeg. Report of the Board of Valuation and Revision on Systems of Assessment and Taxation*, 1917.—75 pp.

[2] *State of Rhode Island and Providence Plantations. Report of the Joint Special Committee on the Taxation Laws of Rhode Island.* Providence, 1910.—183 pp.

[3] *Second Report of the Joint Special Committee on the Taxation Laws of the State of Rhode Island.* Providence, 1911.—98 pp.

[4] *Special Report of the Joint Special Committee on the Taxation Laws of*

porate excess to virtually all corporations. This recommendation was carried out by the legislature early in the next year.[1]

During the early weeks of the year 1910, there appeared two noteworthy reports. The Illinois commission was significant in counting among its members and advisers scholars like President James and Professors Merriam, Kinley and Fairlie. The report is a short one.[2] But the material consists of two large volumes; one comprising an account of the Illinois system by Professor Fairlie [3] the other including a compilation of tax laws and decisions.[4]

Professor Fairlie's report is a real treatise on taxation. Especially noteworthy are the discussions of the undervaluation of real estate, the assessment of mortgages, the taxation of corporations, including an account of the Teachers' Federation cases, and the subject of special taxes and fees. A chapter is devoted to a survey of the corporation tax in some six or eight typical states in this country. On the basis of the conclusions reached by Professor Fairlie, the commission present its recommendations for a constitutional amendment permitting exceptions to the rule of uniformity; the appointment of a state tax commission; and the substitution of county for local assessors.

Pennsylvania, which had in some respects been in advance of the other, states decided to reconsider its system in the same year. After a preliminary report in 1910, a full report was issued in 1911.[5] The committee hold that the existing separation of taxation as between state and localities "is an admirable feature which should be preserved." They recommend a

the State of Rhode Island to His Excellency the Governor. Providence, 1911. —58 pp.

[1] *Cf. supra*, p. 209.

[2] *Special Message of Charles S. Deneen, Governor, to the General Assembly, transmitting the Report of the Special Tax Commission.* Springfield, 1911. —35 pp.

[3] *A Report of the Taxation and Revenue System of Illinois.* By John A. Fairlie, Chief Clerk of the Commission. 1910.—255 pp.

[4] *Compilation of Tax Laws and Judicial Decisions of the State of Illinois, made by Albert M. Kales and Elmer M. Liessmann, under the direction of the Special Tax Commission.* Springfield, 1911.—273 pp.

[5] *Report. The Joint Committee of the Senate and House of Representatives of the Commonwealth of Pennsylvania to consider and report upon a Revision of the Corporation and Revenue Laws of the Commonwealth to the Legislature.* Harrisburg, 1911.—244 pp. The *Preliminary Report* with the same title was 10 pp. in length.

graduated inheritance tax; a flat tax on anthracite coal; an extension of the mercantile license taxes, and a repeal of certain exemptions. They put themselves on record as against the proposal to return to a local personal property tax, and think that the system of a flat rate on securities works well. They incline to the opinion that an increased centralization may accomplish good results, but reserve their decision.

A little later in the year appeared the report of the Virginia commission.[1] The commission posit as an ideal the separation of state and local revenues, but favor for certain practical reasons only a partial separation for the present. Of more immediate importance they consider a centralized permanent tax commission to take charge of the income tax, the failure of which under present conditions they acknowledge. Furthermore, they recommend a low-rate tax on securities and as to corporations, they think a gross earnings tax preferable to the *ad valorem* system. The report is based on a number of separate studies submitted by the efficient secretary, Mr. Douglas S. Freeman, which cover a great variety of points.

The last of the reports that appeared during the year was that of the Michigan commission of three, including Professor Henry C. Adams. A preliminary report was made in October [2] and the final report was published before the end of the year [3] The commission recommend the separation of state and local revenues, although they recognize the fact that the project may not approve itself to the legislature. They therefore advance an alternative plan, the main feature of which is the application to corporations of the Massachusetts corporate-excess method. In addition, they suggest an increase of the inheritance tax, the taxation of interurban railway and of water power companies, and the adoption of the New York secured-debts tax method, but at an annual rate. They do not favor the direct income tax. Finally, they declare themselves satisfied with the present *ad valorem* tax on railroads, and believe that these corporations should not complain even if they are taxed at a higher rate than other persons.

[1] *Report to the General Assembly of Virginia by the Tax Commission appointed to make an Investigation of the System of Assessment, Revenue and Taxation now in force in this State.* Richmond, 1911.—369 pp.

[2] *Preliminary Report of the Commission of Inquiry into Taxation of the State of Michigan,* 1911.—37 pp.

[3] *Report of Commission of Inquiry into Taxation, Michigan.* Lansing, 1911.—53 pp.

The year 1912 witnessed a slight lessening of activities. The Iowa commission,[1] basing their conclusions on a comparative study, report strongly against the reintroduction of the tax ferret system. Although Iowa had just put in force the flat mill rate for securities, the commission report that the system worked badly because of local assessment. They therefore recommend a state tax commission. They declare themselves as impressed with the advantages of at least a partial separation of sources and urge that this be studied by the permanent commission. They state, in conclusion, that Iowa is not yet ready for either a direct inheritance or an income tax, but believe that the time is not far distant when such changes may be introduced with advantage.

The Florida commission content themselves [2] with recommending the separation of sources as well as classification, and present several bills designed to carry their recommendations into effect. Finally, it is to be noted that the taxation of forests had assumed such importance in the northeastern states that a special Connecticut commission submitted a report [3] which culminated in the recommendation that yield, rather than property, serve as the basis of taxation. A similar conclusion was reached by the Massachusetts commission which reported a little later.[4]

In 1913 New Jersey led off with a report [5] which strongly recommends a permanent state tax commission, to assess public utilities and to supervise the local officials. The report makes certain minor recommendations such as the abolition of the poll tax and then goes on to consider a revision of the fundamental basis of taxation. They recommend the exemption of personal property but suggest that, if this be considered too radical, at least the system of classification be introduced. They propose a revision of the inheritance tax as well as of the corporation tax and recommend a business tax to take the place of the personal property tax. As to the income tax, they

[1] *Report of the Special Tax Commission to the Governor of Iowa.* Des Moines, 1912.—156 pp.

[2] *Report of the Tax Commission.* Tallahassee, Fla. (1912).—55 pp.

[3] *Report of the Special Commission on Taxation of Woodland.* Hartford, 1912.

[4] *Report of the Commission on the Taxation of Wild or Forest Lands* Boston, 1914.—98 pp.

[5] *Report of the Commission to Investigate the Tax Assessments in the State of New Jersey.* Trenton, 1913.—64 pp.

are not quite sure as to whether public opinion is prepared for such a step.

Much the same ideas are found in the Utah commission. A preliminary report of 1912,[1] after considering the breakdown of the personal property tax, recommends a low-rate tax on intangibles and the abolition of the poll tax. While the commission agree that an income tax may be desirable in the future, they suggest for the present a graduated inheritance tax. They are, however, not much impressed with the arguments for separation. As a result of their suggestions, a constitutional amendment was submitted to the voters, but was defeated at the polls. The final report,[2] therefore, confessing that there is no hope for the solution of the tax difficulties, contents itself with repeating the suggestions for the inheritance and poll tax and with recommending certain minor changes.

Much more elaborate is the report of the Maryland Commission.[3] After considering a number of lesser matters and recommending a direct inheritance as well as a franchise tax, the commission discusses the so-called Baltimore plan. They find the situation unsatisfactory, chiefly because of the method of local assessments, and put in the forefront of their recommendations a permanent tax commission. They favor a partial separation of sources and suggest a waiting attitude in respect to the income tax. The same year is marked by the appearance of an excellent Connecticut report on the corporation tax[4] which, after giving an account of the development of the law and a survey of the system in other states, recommends the taxation of public service corporations on gross receipts and that of other corporations on a slightly different basis.

Kentucky was so dissatisfied with its system that the special tax commission engaged as expert Professor Plehn of California. A preliminary report[5] followed Professor Plehn in discountenancing the adoption of separation because of the fact that "the main reasons for the introduction of that system in Cali-

[1] *Preliminary Report of the Board of Commissioners on Revenue and Taxation for the State of Utah.* Salt Lake City, 1912.—46 pp.

[2] *Final Report of the Board of Commissioners on Revenue and Taxation for the State of Utah.* Salt Lake City, 1913.—232 pp.

[3] *Report of the Commission for the Revision of the Taxation System of the State of Maryland and City of Baltimore.* Baltimore, 1913.—445 pp.

[4] *Report of the Special Commission on Taxation of Corporations paying Taxes to the State.* Hartford, 1913.—238 pp.

[5] *Preliminary Report of the Special Tax Commission.* Frankfort, 1913.

fornia, do not exist in Kentucky." The commission hold that in view of actual local conditions classification is preferable. In the final report [1] the commission work out the details of such a system and recommend a permanent tax commission. They also believe that Kentucky is not yet ready for an income tax.

Similar ideas are found in the report of the Nebraska [2] commission, who recommend a constitutional amendment designed to permit of classification. They shape their suggestions, however, in an alternative way. In case the amendment should not be adopted, they suggest a permanent tax commission, a change in the inheritance tax, the taxation of corporations on franchise values, and the abolition of the system of fractional assessments. If, however, the constitutional amendment should prevail, they propose a detailed system of classified taxes and suggest that the new Board study the problem of the income tax.

The Virginia commission had as a member Professor Thomas W. Page. Its report [3] is, as a consequence, noteworthy. Basing itself in part of the conclusions of a conference held at Richmond [4] and taking advantage of suggestions for introducing the system of segregation worked out by the State Auditor [5] the commission discuss the need of tax maps in the assessment of real estate and urge a permanent tax commission. They believe in the principle of classification but also in partial segregation. Inasmuch as Virginia already possesses an income tax they suggest a redrafting of the law designed to secure better administration and more justice. Finally, they maintain that a direct inheritance tax is not at this time needed. The administrative problem is also attacked in another Illinois report [6]

[1] *Report of the Special Tax Commission of Kentucky, 1912–14.* Frankfort. 1914.

[2] *State of Nebraska, Report of the Special Commission on Revenue and Taxation.* 1914.—243 pp.

[3] *Report of the Joint Committee on Tax Revision.* Richmond, 1914.—298 pp.

[4] *Proceedings of a Conference held to consider the Ouestion of Tax Reform at Hotel Richmond, Richmond, Va., January 20th and 21st, 1914.* Richmond, 1914.—68 pp.

[5] *Tentative Plan for segregating the Subjects of Taxation presented by C. Lee Moore, Auditor of Public Accounts (1913)*, 12 pp. *Report of the Efforts of the Audtior of Public Accounts to enforce a Compliance with the Tax Laws . . . together with the Tentative Plan for the Segregation of the Subjects of Taxation proposed by the Auditor.* (1914).—89 pp.

[6] *A Report on Revenue and Finance Administration.* By *John A. Fairlie,*

prepared by Professor Fairlie, which enters into the details of fiscal administration and culminates in a recommendation for a central state commission.

The year 1915 is marked by only two reports. The Tennessee committee [1] think that a change of the constitution is necessary as a preliminary to all reform, but urge the appointment of a central state tax commission. So far as intangible personalty is concerned, they recommend a ten per cent income tax on securities in preference to the present system. In Georgia the impetus to tax reform was given by the Athens Chamber of Commerce a committee of which made a series of succinct recommendations including separation, classification, apportionment according to expenditure, an inheritance tax, and a permanent tax commission.[2]

The year 1916 witnessed great activity. The New York committee [3] which enjoyed the services as secretary of Professor H. A. E. Chandler of Columbia, discusses the failure of the personal property tax and finds no merits of the listing system. Much attention is paid also to the unsatisfactory system of taxing corporations. The conclusion is that classification affords no remedy for the New York situation and that what is needed is an income tax applicable to individuals and corporations alike. The administrative features of such an income tax law are discussed in detail and the draft of a bill is appended. The minority report [4] agrees as to the unsuitability of classification but prefers a habitation tax to the direct income tax.

The movement in favor of an income tax had in the meantime made such progress in Massachusetts that a special commission was appointed to draft a bill to that effect. The report of the commission [5] works out the details of such a plan so far as concerns incomes from securities and from personal exer-

Prepared for the Efficiency and Economy Committee created under the Authority of the 48th General Assembly. State of Illinois. (1914).—103 pp.

[1] *Report of Committee to Investigate Assessment and Taxation in the State of Tennessee.* Nashville, 1915.—108 pp.

[2] *The Athens Plan. Report of Committee on Tax Revision.* Athens, Georgia (1915).—16 pp.

[3] *Report of the Joint Legislative Committee on Taxation in the State of New York.* Albany, 1916.—295 pp.

[4] *Minority report of the Joint Legislative Committee on Taxation.* Albany, 1916.—47 pp.

[5] *Report of the Special Commission on Taxation.* Boston, 1916.—126 pp.

tions and suggests an increase of the powers of the tax commissioner. The commission also discuss the distribution of revenues as between the state and localities. In contradistinction to the New York report, however, they declare themselves as not yet entirely convinced as to the advisability of applying the income tax to corporations. The consequence was that while in New York the corporate income tax preceded the personal income tax by two years, in Massachusetts the reverse was true.

The New Hampshire Report [1] limited itself substantially to a discussion of the inheritance tax, the history of which is traced in detail, together with a comparative table. The result of the recommendation was the adoption by Rhode Island of an inheritance tax not only on estates but also on shares. The Indiana commission [2] although characterizing the prevalent method as a "legalized system of robbery" content themselves with recommending a permanent Board of Tax Control, together with a limitation of tax rates. They refuse to consider either classification or the income tax, because of constitutional difficulties. More deserving of attention is the minority report of Professor Rawles, who proposes a constitutional amendment with suggestions along the line of both classification and income taxation. The Kentucky Commission, taking advantage of the constitutional amendment adopted as a result of the labors of the special commission two years before, submitted a report [3] working out the details of the classified property tax which had now become possible and providing for a modified separation of sources. Both of these plans were soon adopted by the legislature.[4] Of somewhat less importance is the Virginia report [5] which in addition to making various minor suggestions states that "the system of partial segregation of the subjects

[1] *Special Report of the Board of Tax Commissioners made to the Governor on New Sources of Revenue.* Providence, 1916.—68 pp.

[2] *Report of the Commission on Taxation to the Governor.* Fort Wayne 1916.—xlv, 408 pp.

[3] *Report of the Kentucky Tax Commission.* Frankfort, 1916.—42 pp. This was based in part on the monograph *Taxation of Real Estate and Personal Property in Kentucky. Address to the Kentucky Tax Commission from the State Tax League.* (1916).—80 pp.

[4] The beneficial results of the change are explained in *Brief on the Subject of Classification and Separation of Property for Taxation.* Submitted to P. N. Clarke, Secretary Committee on Tax Reform representing the State Tax League. Louisville, 1917.—24 pp.

[5] *Report of (Va.) State Advisory Board on Taxation* (1916).—31 pp.

of taxation now in force is generally satisfactory." Finally, it may be mentioned that the same year marked the report of the Hawaii Commission,[1] the chief recommendations being a graduated inheritance tax, new stamp taxes, an amendment of the income tax and the adoption of the Somers system in the assessment of real estate. The commission also suggest the abolition of the assessment of leasehold interests.

The year 1917 is marked by two reports. The California commission [2] was much influenced by the movement in favor of some increase in the taxation of land values. Basing themselves largely on Professor Plehn's study of the English land taxes, they recommend a constitutional amendment authorizing a tax on the future increment of land values. Perhaps the most significant part of the report, however, is the suggestion that before long a state income tax would be desirable. The Connecticut report [3] presents a review of the tax system as it had developed since the introduction of the business or income tax on corporations. The commission consider the possible introduction of a direct or indirect income tax on individuals, but decide on the whole to content themselves with less radical suggestions. On the other hand, the committee of the Connecticut Chamber of Commerce, basing themselves largely on a special report made for them by Professors Fairchild and Walradt, declare [4] that the Connecticut system of taxing intangibles is unsuccessful and recommend the introduction of a personal income tax.

In 1918 the movement of reform spread to the Southern states. The Mississippi committee,[5] realizing the difficulty of putting through radical suggestions of a centralized tax administration, content themselves with a compromise, but suggest a gradual modification of the privilege taxes, a centralization of the unsuccessful income tax, and the adoption

[1] *Report of the Special Commission on Taxation for the Territory of Hawaii.* Honolulu, 1916.—12 pp.

[2] *Report of the State Tax Commission of the State of California.* Sacramento, 1917.—280 pp.

[3] *Report of the Special State Commission on the Subject of Taxation.* New Haven, 1917.—44 pp.

[4] *Report of the Joint Committee on Taxation on State Finance to the Connecticut Chamber of Commerce embracing the Report of a Special Study of the Connecticut Tax System.* New Haven, 1917.—67 pp.

[5] *Mississippi Legislature, 1916–18. Joint Report of the Senate and House Committee a pointed to consider the State's Revenue System in Fiscal Affairs.* Jackson, 1918.—63 pp.

of a progressive inheritance tax. The Georgia report [1] recognizing the failure of the general property tax, joined to the proposal for a tax commission the adoption of classification, the creation of an income tax and an extension of the inheritance tax. The Louisiana report [2] is less drastic and limited itself to the recommendation of an inheritance tax and the extension of the franchise tax on corporations. In Montana also the discontent was loud, and a special commission reported [3] in favor of a permanent tax commission, classification, the exemption of mortgages and a reform of corporate taxation. The report of the Massachusetts joint committee [4] dealt primarily with a budget system and recommended the adoption of the pay-as-you-go policy.

The year 1919 saw redoubled activities. The Massachusetts report [5] discussed two points—a better method of distributing the revenue from the income tax and the extension of the income tax to corporations. The Ohio committee, which enjoyed the assistance of Professor Lutz, submitted a report [6] recommending a graduated inheritance tax, an income tax, and the limitation of local indebtedness. Perhaps the most noteworthy publications of the year, however, were the Canadian reports. Most of the western provinces and municipalities had gotten into trouble through the exemption of improvements from taxation. British Columbia issued several reports [7] culminating in the suggestion of an income tax. This was based largely on the findings of Professor Haig, of Columbia, who had also made a preliminary report on Saskatchewan.[8] Similar expert as-

[1] *Report of the Special Tax Commission for Georgia.* Atlanta. 1919.—88 pp.

[2] *Legislative Recommendations made by the Board of State Affairs to the General Assembly of Louisiana.* Baton Rouge, 1918.—37 pp.

[3] *Montana Report of the Tax and License Commission to the State Board of Equalization.* 1917–1918. Helena, 204 pp.

[4] *Report on State Finances and the Budget, submitted to the General Court by the Joint Special Committee on Finance and Budget Procedure.* Boston, 1918.—85 pp.

[5] *Report of the Joint Special Committee on Taxation.* Boston, 1919.—119 pp.

[6] *Report of the Special Joint Taxation Committee of the 83d Ohio General Assembly.* Columbus, 1919.—165 pp. Pages 85–126 contain the *Report on the Operation of State Income Taxes*, by Harley L. Lutz.

[7] *Reports of the Board of Taxation with a Report on Taxation in the Province of British Columbia.* By Robert Murray Haig. Victoria, 1919.—135 pp.

[8] *Taxation in the Urban Municipalities of Saskatchewan. A Report to*

sistance was rendered by Professor A. B. Clark, of the University of Manitoba, to the commission of that province, whose comprehensive report [1] recommended the reimposition of a tax on improvements; the taxation of real estate, of business and of income for local purposes; the taxation of corporations and inheritances together with a supplementary revenue tax for provincial purposes; and the abolition of the poll tax.

The year 1920 is marked by a short New Jersey report.[2] As between classification and the income tax as substitutes for the personal property tax, the commission consider the former a mere palliative. They therefore recommend the income tax together with a tax on business. The Delaware commission [3] state that the state "has no system of taxation." As a preliminary to all improvements they urge a permanent tax commission. The most elaborate report of the year is that of New Mexico [4] which again enjoyed the advantage of Professor Haig as special counsellor. The report recommends a permanent tax commission and a state income tax and devotes especial attention to mine taxation, urging the practicability of the *ad valorem* system.

Finally, the year 1921 witnessed the progress of the reform movement into the southern states. The South Carolina report [5] which describes the situation as "a state of anarchy" recommends an inheritance tax, a classified property tax, and a supplementary income tax. The Louisiana commission fall into line by suggesting [6] not alone the above imposts, but also

the Government of the Province of Saskatchewan. By Robert Murray Haig. Regina, 1917.—48 pp.

[1] *Province of Manitoba. Report of the Assessment and Taxation Committee 1919.*—217 pp. Professor Clark's report which is found in the appendix was reprinted with additions as *An Outline of Provincial and Municipal Taxation in British Columbia, Alberta, and Saskatchewan* (Winnipeg, 1920).—97 pp.

[2] *Report of the Commission to investigate Tax Laws.* Trenton, 1920.—40 pp.

[3] *Report and Recommendations of Delaware State Survey Commission.* 1920.—95 pp.

[4] *Report of the New Mexico Special Revenue Commission.* Santa Fe, 1920.—324 pp.

[5] *Report of the Joint Special Committee on Revenue and Taxation.* Columbia, S. C., 178 pp.

[6] *State of Louisiana. Report of the Assessment and Taxation Commission to the Constitutional Convention.* 1921.—237 pp.

a business tax, a corporation tax, a severance tax on natural resources, and a centralized tax administration.

VI. *Conclusion*

From the above survey several facts stand out prominently. In the first place, the dissatisfaction with the general property tax and the recognition of the evils connected with the assessment of personalty have now become well-nigh universal. Whereas formerly they appeared in only a few states, they are now expressed by every one of the special state tax commissions without exception, and by almost all the permanent tax commissions. Since a recognition of the evils to be overcome is the first condition of progress, this may be considered a substantial advance.

In the second place, there is a growing recognition of the weakness of the local assessment of property, whether real or personal. What Sidney Webb has recently called the "American anarchy of local autonomy" is slowly being recognized by the administrative officials themselves. Nothing, perhaps, has been more cheering during the last few years than the progress of centralization of assessment and the creation of permanent commissions designed to cope with this evil. The movement has only just begun, and from its continuance much may be expected in the future.

In the third place, there has been a great spread of the idea of the separation of state and local revenues in the sense of the abandonment of the sole, or even the chief, reliance by the state on a locally assessed direct property tax. More and more states have come to depend on centrally-assessed corporation and inheritance taxes. The earlier need of a complete separation of sources as realized in California and at one time in New York has more recently, however, become unnecessary, partly because of the device utilized by Connecticut to overcome the weakness of an apportionment by value [1] and partly because of the development of the centrally-assessed state income taxes, with the adoption of the principle of division of yield.

Fourthly, the discussion of possible substitutes for the personal property tax has made considerable progress. At one time the device of classification seemed to promise good results, and even at the present time (1921) almost all the commis-

[1] *Cf. supra*, p. 363.

sions in states with rigid constitutions are in favor of relaxing the constitutional prohibition. But within the past few years this movement has been replaced by the tendency to substitute for the old locally-assessed personal property tax the new centrally-assessed state income tax. This tendency has been notably strengthened by the recent reforms in New York and Massachusetts.[1]

Finally, perhaps the most encouraging results of the last decade have been the increasing attention given to the problem; the great improvement in the character of the commissions, both special and permanent; the utilization to an ever increasing degree of the expert and of the professional economist; and the evident determination on the part of the various commissions to keep abreast of the best action and of the best thought in the other commonwealths.

It may indeed now be said that the movement for tax reform is *en train*. Never before has so much attention been devoted to it. Never before has there been so intelligent and so vigorous a discussion. Never before has there been manifested such anxiety to deal correctly and yet conservatively with the problem. To this result the annual conferences of the National Tax Association have contributed not a little, and we may expect to witness during the next few years a still more decided evidence of the progress which has now become so marked and so widespread in the United States.

[1] *Infra*, p. 659.

CHAPTER XX

THE NEXT STEP IN TAX REFORM [1]

WE have been discussing for many years, the problem of the reform of our state and local system of taxation. While there has been no complete agreement as to the remedy, there has been a virtual unanimity in the diagnosis of the disease. The three fundamental shortcomings of our present system, apart from many minor evils, are recognized to be the persistence of the general property tax as the sole or principal source of revenue; the system of purely local assessment; and the utilization of the real estate tax for both state and local purposes. By far the larger part of dissatisfaction with our system is referable to one or other of these facts. And it is a cheering sign of progress that whereas a decade or two ago. this analysis was recognized by only few students, still fewer officials and a very insignificant fraction of the general public in the most advanced industrial states, there is at the present day a widespread acceptance of its truth in almost every state of the union and in continually larger sections of the population.

As to the remedies, however, we have by no means progressed so far. On one point, indeed, it may be said, that there is now also almost complete unanimity—namely, the necessity of central fiscal administration or at all events of greatly increased central control over the local administration. The accuracy of this statement is attested by the recent creation of the numerous state tax commission which have been, and still are, doing such admirable work in improving fiscal conditions. But further than that, we have scarcely gone.

In a few of our states indeed, which have been entirely untrammeled by constitutional restrictions, the old general

[1] Reprinted, with a few changes to bring the matter down to date, from the Presidential Address at the *Ninth Annual Conference of the National Tax Association*. San Francisco, Aug. 11, 1915.

property tax has been supplemented by specific taxes—often loosely called indirect taxes—on corporations, inheritances and the like; and in a very few cases some particular categories of personalty have been taken out of the general property tax and treated in a special way. And in not a few states, the recent movement in the direction of tax reform has consisted in an attempt to modify the strict limitations of the constitution so as to permit of the introduction of this system of a classified property tax.

I. *The Classification of Property*

That the movement toward a classification of property for purposes of taxation is a step in advance will scarcely be questioned. For anything that releases us from dependence on the general property tax, as almost everywhere understood, is warmly to be welcomed. More recently, however, there has developed a situation which is calculated to give us all pause and to lead us to study the problem from a new point of view. What we refer to is the fact that in one of the most advanced states, New York, which was unhampered by its constitution, which had by law taxed certain kinds of personal property in a special way and at a special rate, and which had in practice well-nigh exempted other forms of both tangible and intangible personalty,—in this state the need has recently arisen for a vastly increased revenue, for the purposes both of the state and of the City of New York. It was estimated that to put the state on a sound fiscal basis, an additional revenue of from at least twenty to thirty millions would be needed, chiefly in order to defray the interest and amortization costs of the large debt incurred, and hereafter to be incurred, for the enlargement of the Erie Canal and for the construction of an improved system of state highways. In the City of New York alone, a similar additional revenue of from twenty to thirty millions a year would be required partly because of the adoption of the pay-as-you-go policy of financing capital improvements, partly because of the exigencies of the Rapid Transit situation and partly because of the needed contributions to the state revenue.

The sudden injection of these additional obligations into the New York situation have raised the entire problem in a much more acute form than anywhere else. For in most com-

monwealths where there is a movement toward a classified property tax, the problem is primarily one of justice in taxation. It is in a certain sense an ethical, rather than a fiscal, problem. It is not so much a question of securing more revenue, as of substituting a superior for an inferior method of securing the same revenue—a revenue that might be expected gradually to increase with the progress of wealth and population. But in New York, where the old general property tax has in a large measure disappeared in practice and where the evils of unequal taxation, although by no means absent, are not so glaring or so acutely felt as in those states which still make the vain attempt to enforce the tax with rigor, the real problem is that of securing a greatly increased revenue, without imposing upon real estate a rate of taxation which would be so high as to be virtually confiscatory. It is of course, not intended to deny that the need of increased revenue is not being more and more strongly felt in other states; but in none of them, to our knowledge, has such a crisis been suddenly precipitated upon an unprepared public.

This situation has caused a rude awakening to those who have always considered New York in the forefront of tax reform in that the Empire State has made greater progress than most of the other commonwealths in its practical departure from the old general property tax. The exigencies of the new situation led to the appointment both of a State Legislative Committee and of a Mayor's Tax Committee in the City of New York, and are thus causing a reconsideration of the entire problem. According to the views commonly expressed, there are only two solutions: either the continuation of the present New York system, which would mean, in practice, an immensely increased tax rate on real estate; or, on the other hand, the attempt to tax in a greatly extended form those classes of tangible and intangible personalty which are now either taxed at an insignificant rate or not reached at all.

Whereas, therefore, in most of the states which still have the old general property tax, the movement toward a classified property tax might be welcomed as a means of escaping from an antiquated and increasingly unendurable system, in the City of New York which already has the new system in part, the problem arises as to whether we shall still further develop this new system or cut loose from it entirely. The

problem, in other words, is not so much the superiority of a classified property tax over the old general property tax (which in practice no longer exists), as the relative advantages and disadvantages of a classified property tax compared not with the general property tax, but with something that is possibly better than either.

Regarded from this point of view, the shortcomings of a classified property tax are obvious.[1]

In practice a classified property tax must be a low-rate tax on certain forms of personalty and especially of intangible personalty. Such a system has been in vogue for many decades in Pennsylvania. Here, however, we are told by the Pennsylvania commission of 1911 that the low-rate tax on personal property has been only "more or less successfully collected." The sole part of the tax which has been a conspicuous success is stated to be the tax on mortgages. Yet in the state of New York any attempt to levy even a low-rate annual direct tax on mortgages would meet with the strenuous opposition of the real estate interests, large and small, at all events in all of the cities, because the experience of a decade ago has convinced everyone of the undoubted economic truth that under the conditions existing in New York a direct tax on mortgages is inevitably shifted to the borrower. The commission further tells us that "so far as Pennsylvania clings to the personal property tax in vogue, in other states, by attempting to tax other money investments, she undoubtedly suffers the same failure as the other states."

[1] As the purpose of the original address, from which this chapter is reprinted, was to prevent the state of New York from adopting the classified property tax, especial stress was laid on the defects, rather than the merits of the system. The object of this address was attained, and within a few years New York followed the advice here proffered. The defects of the system are minimized in C. J. Bullock, "A Classified Property Tax" in *Proceedings of the Third Conference of the National Tax Association* (1910), p. 95. After Professor Bullock's failure to persuade Massachusetts to accept his plan of reform, he somewhat modified his view in "The State Income Tax and the Classified Property Tax" *Tenth Conference* (1917), p. 362. Further experience may lead him to modify his conclusion that "the state income tax should not be regarded as the rival, but rather the complement, or helpmate, of the classified property tax" (p. 384). Prof. H. L. Lutz, *The Classification of Property for Taxation*, Columbus, 1919, takes the more defensible position of "setting forth the advantages of classification as a preliminary stage of tax reform."

In other words, the official verdict on the situation in Pennsylvania is that the low-rate tax on intangible personalty, apart from the tax on mortgages, is just about as much of a failure as the ordinary tax levied elsewhere on personalty. In 1913 the four mills tax was changed, becoming a county tax instead of a state tax, and mutual insurance companies were now exempted on their mortgage bonds and on their interest payments.

In Connecticut, the low-rate tax on choses in action has been enforced since 1890.[1] But, as everyone who is acquainted with the condition knows, it is almost a complete farce.[2] In Maryland, where the low-rate tax on certain intangibles (securities) was introduced in 1896[3] and has been administered by officials of remarkable ability, there is no pretense of any idea that real equality in taxation is attained or that great evasions are not practiced. Outside of Baltimore at large the system is conceded to be a notorious failure.[4]

Even in the states where the reform has been introduced more recently and where some encouraging progress has been made under the guidance of efficient permanent tax commissions, it is to be emphasized that the low personalty tax, whatever may be its advantages over the old general property tax, has not proved a conspicuous success as a source of large additional revenue. In Rhode Island, where the low-rate tax on intangibles was introduced in 1912 and where, as is natural, the assessment considerably increased, it is impossible to ascertain whether the revenue from this class of personalty is now more or less than before. It is to be observed, however, that, despite the notorious escape of intangibles before the enactment of the new law, the increase in the assessment of intangibles has

[1] In 1897 the rate was increased from 2 to 4 mills.

[2] *Cf.* F. R. Fairchild, "Registration Taxes on Intangibles, with Special Reference to the Connecticut Chose-in-Action Tax," in *Proceedings of the Twelfth Annual Conference of the National Tax Association*, 1920, p. 152. Professor Fairchild emphasizes the general position taken in this chapter by saying "that there was a readiness, altogether too optimistic I think, to assume that the low-rate taxation of intangibles has been a success."

[3] At the rate of 3 mills for local purposes. In 1914, 1½ mills were added for state purposes.

[4] The assessment of securities in 1919 outside of Baltimore city and county was $35,407,499 out of a joint property assessment of $473,627,672. *Cf. Third Biennial Report of the State Tax Commission of Maryland*, 1920.—pp. 28.

been only slightly more than that of real estate,[1] and that the tax commissioners do not attempt to conceal their disappointment.[2] In Minnesota, where the law was introduced in 1911 and where exact comparative figures are ascertainable, the revenue at first actually fell off; since then under an admirable administration the revenue has grown substantially but is still comparatively insignificant.[3] In the years 1911–1914 the

[1] The figures are as follows:

	Assessment of Real Estate	Assessment of Intangibles
1912	$432,200,838	$96,758,872
1913	449,732,569	115,129,149
1914	459,653,296	123,953,431
1915	469,375,088	126,715,594
1916	478,782,040	135,736,347
1917	499,643,761	145,927,531
1918	510,915,710	149,554,960
1919	525,410,481	168,977,318
1920	599,134,386	203,499,468

The above figures of intangibles include only the intangibles locally assessed, and not the securities of corporations, trust companies and banks, which are subject to what are elsewhere called corporation taxes and which in Rhode Island were formerly, in part at least, subject to local assessment. It must also be remembered that the new law permits the offset for indebtedness against certain intangibles and not, as formerly against tangibles, thus reducing the taxable amount of intangibles.

[2] "This increase in the assessed valuation of intangibles, falls far short of reaching anything like the full amount of such property taxable in the state, and in some cases its absence from the tax roll is inexplicable except upon the hypothesis that the omission is intentional." *Eighth Report of the Tax Commissioners made to the Governor of the State of Rhode Island for the Biennial Period, 1919–1920.* Providence, 1921.—p. 17. This reads like the old complaints before the adoption of the system of classification.

[3] The figures are as follows:

	Number assessed	Assessment	Revenue
1910	$ 6,200	$13,919,806	$379,754
1911	41,439	115,481,807	346,445
1912	50,564	135,369,314	406,107
1913	57,068	156,969,892	470,909
1914	73,266	196,548,307	589,644
1915	73,062	212,134,901	636,404
1916	74,219	234,136,268	702,588
1917	87,688	284,968,875	854,907
1918	98,502	330,300,219	990,900
1919	109,215	359,798,976	1,079,399
1920	127,471	437,628,371	1,312,886

assessment of intangibles increased from $115,676,126 to $197,625,914; but in the same period the assessment of real estate (exclusive of town and city lots) increased far more, namely, from $664,930,374 to $872,296,355. And in 1914 the assessment of intangibles was still pitifully small when compared to the assessment of other property in general—the figures being 196 and 1,475 millions of dollars respectively.[1] In fact the able tax commission tells us very frankly: "It is doubtful if the returns this year, large as they are, represent more than one third of what they should be.[2] Finally in Iowa, where the low-rate tax was introduced in 1911, the revenue was now undoubtedly much smaller than before. It is true that under the new law somewhat more "moneys and credits" were assessed: but as the new rate was only 5 mills the proceeds were actually much less. The exact figures are not ascertainable from the auditor's reports without laborious computation; but a member of the state tax commission states that the amount of revenue was reduced at least one-half.[3] Whatever, therefore, may be claimed for the low-rate tax, it does not seem probable that the amount of additional revenue which it would quickly yield would be its strong point. It is altogether likely that whatever the ultimate revenue might be, it would be slow in developing.[4] It is hence questionable

[1] In 1920 the situation was about the same, the figures being 437 and 2,115 millions respectively, and there having been no reassessment of real estate in that year.

[2] *Report of the Minn. Tax Commission*, 1914.—p. 74. They add: "but we are making progress. . . . While we may never succeed in reaching all of the property, even under the present method, yet we believe, all things considered, that it is a decided improvement over the old general property system." In this conclusion every one will of course concur. Nevertheless, the chairman of the commission, Mr. Lord, now (1921) strongly urges the adoption of an income-tax law.

[3] Professor J. G. Brindley writes that "I am not able to give you a statement of the actual revenue derived. . . . But in view of the fact, that the listing of moneys and credits only slightly increased, the amount of revenue very materially decreased. . . . It is safe to say that the amount of revenue was decreased by at least one-half as a result of the new law."

[4] While it is true that the revenue from the tax later on gradually increased, the change did not begin to keep pace with the increase in the general state revenue. This is apparent from the table on the next page.

In the note published in *The Quarterly Journal of Economics*, xxx (1916), pp. 588–595, Professor Brindley expresses the opinion that the real explanation of the lack of success of the classified property tax in

whether the project would be of advantage in commonwealths situated like New York.

Moreover, while freely conceding the inestimable superiority of a classified property tax over the existing general property tax,[1] it must be remembered that even if there were an entirely admirable administrative system in vogue, and even if the fiscal results were wholly satisfactory, there still are two considerations which should give us pause. The first is that under modern economic conditions no attempt to assess a tax on intangible personalty can ever be completely successful. The general property tax arose at a time when the economic unit was local in character and when it was entirely possible for the local administration to assess the property of the individual. The same was true to a large extent of the early conditions of American economic life, and it is still in part true of the more primitive of our rural communities. But under our modern industrial and capitalist development, the basis of personal property has become national or even international instead of local and the great mass of personalty is now of an intangible character. Under such conditions and especially where the old and still surviving political and legal considerations run athwart the economic facts, the attempt to reach intangible personalty

Iowa is defective administration. A few years later, however, Professor Brindley expressed his preference for a state income tax. *History of Taxation in Iowa, 1910–1920*, 1921, p. 51.

Statistics of the Iowa Tax on Intangibles

	Flat rate tax on money and credits	*State share of flat tax*	*Total state revenue*
1912	$ 945,996	$77,370	$4,983,448
1913	1,053,563	88,053	5,423,111
1914	1,259,143	97,784	6,100,660
1915	1,376,809	102,111	6,706,484
1916	1,536,293	107,244	8,546,046
1917	1,649,773	169,882	9,236,819
1918	2,180,344	193,839	11,569,658
1919	2,341,389	202,035	13,908,135
1920	3,137,938	238,791	20,225,742

[1] This superiority has recently been strikingly attested in Kentucky, since the introduction of classification in 1917, as appears from the following figures of revenue from intangibles as compared with land:

	1917	*1921*
Bank deposits	$ 61,474	$ 284,161
Intangibles	378,129	1,233,674
Lands	2,154,321	2,943,218

meets with almost insuperable difficulties. Especially in communities like New York City, which are situated at the state border, the opportunities for evasion are singularly multiplied.

It will be replied that a low-rate tax will remove this temptation to evasion. It must be remembered, however, that even a four or five-mill rate represents in a large mass of securities an income tax of about ten per cent; and he would indeed be optimistic who holds that such a burden would not be appreciable, or would not lead men into temptation. Any system of taxation which needlessly multiplies the temptations to evasion is to deprecated. Under the existing legal system in the United States, the conflict between location and residence in the matter of the taxation of personal property is indeed an irrepressible conflict. The result, even with the most admirable administration, is bound to be inequality and injustice.

But the second consideration is still more weighty. For the objection inheres in the very theory of the property tax. As we have had frequent occasion to point out, under modern economic conditions, property and especially personal property, is no longer a satisfactory index of tax-paying ability. Wealth in modern times is derived to a continually larger extent from relations, from opportunities, and from all manner of exertion more or less indirectly, or not at all, connected with property. Huge official salaries and large professional incomes are a common occurrence to-day and would go entirely free under a property tax. Individual and corporate profits derived from good-will, from franchises, from govvernmental favors and opportunities constitute an increasing flow of wealth which is either not at all, or only in part, incorporated into changes of capital value. Business men in general throughout the United States are slowly coming to the conclusion that their tax-paying ability is in no direct relation to their stock in trade. In certain classes of enterprise like forestry, for example, it has come to be almost universally recognized that a system of taxation based on property is opposed to the best interests of the community as a whole.

It cannot be denied that in the case of real estate in general and especially in the case of city real estate, the advantages of an assessment of property are great; but it is to be remembered that in such cases every change in profits or yield is at once

reflected in a change in the capital value of the property. As has just been pointed out, however, this consideration is true to a much smaller extent of the great mass of modern profits or incomes. To the extent that it is not true, property is losing its former value as a criterion of tax-paying ability.

It is largely for this reason that any kind of a tax on personalty would not be only unpopular but hazardous in a large center like New York City. Merchants' stock in trade is now virtually not taxed at all in New York. If it were to be assessed at what might appear to be even a comparatively low rate, there would be grave danger of its seriously interfering with the prosperity of New York as a manufacturing and jobbing center. For the stocks in trade of many businesses in New York are out of all proportion to their profits. And if in addition an attempt should be made to levy even a small tax on intangible personalty consisting of securities and bank deposits, it is clear that the financial dominance of New York might be very seriously menaced, because even a low tax on such property would be out of all proportion to the profits from the turnover of the property. What is true of New York City would come to be true before long in a corresponding degree of other large commercial and financial communities.

Let us recognize the fact then, once and for all, that a system of property taxation, except in so far as certain forms of real estate are concerned, is unsuited to modern economic conditions as the ordinary and principal source of revenue, however strong the arguments may be for its utilization in exceptional crises as in the European *post-bellum* situation. Let us boldly face the situation and confess that while a classified property tax may constitute the only possible step in advance for those states that are still tied up by a rigid constitution, the scheme is inapplicable to, or undesirable for, those states which are more fortunately situated from the constitutional point of view; and that even in the former class of states the energy that is being developed in the promotion of a classified property tax might more profitably be directed to what is at all events a more thorough-going remedy.

II. *The Income Tax*

What then is this better remedy and what is the next step for states like New York? We have no hesitation at the present

time in answering: the substitution of income for property as the basis of taxation.

This will perhaps come as a surprise from one who has uniformly resisted the introduction of a state income tax in the United States.[1] Several things must, however, be remembered. In the first place, we have now for more than twenty years been striving, as best we could, to call attention to the shortcomings of property as a theoretical basis of tax-paying ability. In the second place, we have always advocated the policy of taxing corporations on a net-receipts or income basis. Thirdly, we have always been in favor of a federal income tax in general and have contributed our modest share toward the elaboration of the present act. The struggle over the ratification of the sixteenth amendment was so acute in important states like New York that any advocacy of a state income tax would surely have killed the prospects of ratification. In the fourth place, our objection to a state income tax has been almost entirely due to the belief that, with the administrative methods then almost uniformly in vogue, it would be just about as difficult to localize income for purposes of taxation as it has been, and still is, to localize property.

Two events, however, have recently occurred to cause a reappraisement of the situation. In the first place, great progress has been made in the direction of a centralized state administration. In New York we now have under the law of 1915 at all events a distinct step in the direction of more efficient fiscal administration. Of greater significance is the fact that the situation has been entirely altered by the introduction of the federal income tax. We have now gotten people, and especially business people, accustomed to an income tax; and while there are still grave problems to be solved and improvements to be secured, it may be stated, without fear of contradiction, that the income tax has come to stay and that in principle it is not seriously opposed by the community. With the existence of this new tax, which is successful so far as it goes, there arises the hitherto entirely unexpected prospect of a state income tax being able to lean up against the federal tax, so as to avail itself of the federal returns and to be able in this way to minimize a great part of the difficulties

[1] The earlier attitude of the author in deprecating state income taxes while urging a federal income tax may be seen in the 1911 and 1914 editions of his work entitled *The Income Tax*.

which would otherwise attach to an independent state income tax.

An example of what we mean—and it is noteworthy as being the pioneer in this country—is the Connecticut law of 1915 imposing a state tax on business corporations. When the present writer was summoned by the Connecticut manufacturers to advise them, he found them up in arms against the proposition to introduce into their state the Rhode Island system of corporate-excess taxation which had only recently been adopted there. It was our good fortune to be able to advise them as well as the legislature to prefer to any scheme of property tax a system of taxes on business income based upon the federal law. Such a system was finally worked out by Commissioner Corbin of Connecticut, and the result was a law whereby business corporations in Connecticut duplicate for state purposes the returns made by them to the federal government.

Our suggestion, therefore, is that in New York as well as in other states which are ready for this next step, the entering wedge which we find in Connecticut should be pushed further in, and that an income tax should be assessed by the state tax commission according to a law which would be largely patterned on the federal act and which would require as far as practicable a duplication of the returns handed in to the federal government.

New York is in fact now even better fitted for the introduction of such a system than are some of the other states. For so large a part of all individual and corporate incomes is received in New York that even a very small rate would yield a large additional revenue. Even assuming that only an additional normal tax of one per cent were levied for state purposes and another one per cent for municipal purposes for New York City, the added revenues would yield an income entirely adequate to the present and future fiscal needs of the state and city and would render unnecessary the re-imposition of any so-called direct state tax. What is true of New York is true to a large extent of the other prominent industrial states; and even in the remaining states, which are ready for the next step of such an income tax, the income tax might, especially if the exemption were lowered, prove to be at least an acceptable substitute for the personal property tax.

The adoption of any such plan would of course have to be thought out very carefully.

The rate of taxation for state or for local purposes should be only the normal rate of one per cent. If a graduated scale were introduced, as in the federal tax, it might easily happen that the combined federal, state and municipal taxes on large incomes would reach a figure which would probably be considered grievous or even confiscatory. A one per cent tax for state purposes, or at the outside a two per cent, part of which might be returned to the localities, would be as much as it would be prudent to add to the federal tax.

On the other hand, the high exemption which is now granted under the federal law ought to be reduced. The limit of exemption should certainly for state and local purposes, be brought down to at least $2,000, and perhaps even to $1,500. For whatever may be said as to the desirability of making large exemptions in the federal tax in order to serve as a makeweight to the internal revenue and tariff taxes, the argument would not apply to state and local taxation where there are few, if any, taxes on consumption. If, however, the limit of exemption were reduced, the revenue would be correspondingly augmented. Here again, the administration of the law would be greatly facilitated by an amendment to the federal act requiring all persons with a gross income (not a net income) not exceeding the minimum exemption to make returns. This would in all likelihood render unnecessary few if any new or additional returns to the state officials.

An important point is as to who should be subjected to such an income tax. This phase of the subject is really the most difficult. It has three different aspects: (1) affecting the residence of the taxpayer; (2) dealing with the proportion of income subject to state law; and (3) having reference to the relation of individual to corporate taxation. Let us say a word about each of these points.

All incomes are in last resort received by individuals and, on the other hand, all incomes are derived either from property, from earnings apart from property, such as professional salaries, or from exertions or relations which may or may not be connected with property and which are usually summed up under the general name of business. The difficulty arises from the fact that the source and the recipient of the income are not coterminous. The one may be within the state, the

other without the state. In a federal income tax, these problems arise only in international relations and are of minor importance. But within the several commonwealths of a union or federation, the subject assumes grave dimensions.

From the ideal point of view an income tax might be considered as a strictly personal tax, and the recipient of the income would then pay a tax in accordance with the income received. But under existing conditions, both political and legal, such a theory is inapplicable to a state income tax. We should have the same difficulties that now confront us in the general property tax, where the controlling consideration is the legal residence of the tax payer. It is therefore essential to adopt another theory of the income tax; the theory, that the tax is imposed not only on the recipient, but also on the source of the income, making provision, as we shall see later, for the avoidance of double taxation. In other words, just as we sometimes speak of a property tax being imposed either upon the property or upon the property owner, so we can conceive of the income tax as a tax either on the income or on the recipient of the income. If the latter is called a tax on the person, the former may be called a tax on the thing, that is on the income irrespective of the recipient. The one would be a personal tax, the other would be an impersonal tax.

This distinction is of the utmost importance, for it would otherwise be impossible for a state to reach incomes which are earned or derived within the state and which are finally paid over to individuals having a residence outside of the state. With this double conception of the income tax, however, which is in harmony with the jurisprudence of the subject as thus far elaborated in the United States, the solution of this particular difficulty is simplified. The income tax must be treated not only as a tax upon the incomes of legal residents of the state, but also as a tax upon all incomes earned or derived within the state, irrespective of the legal residence of the recipient. In the latter aspect it might be called a business tax; but we hesitate to use this term because it is not broad enough, and because the income may be received by someone who is technically not in business at all. We prefer the verbal distinction between a tax on the source and on the recipient of the income.

The practical result is that there would be subject to a state income tax not only all the persons legally resident within

the state, but also all incomes earned or received within the state, whether these incomes are derived from property within the state, from business carried on within the state, or from relations or privileges existing within the state.

While the administrative difficulties of such a dual income tax would not be great, they would be largely diminished by another suggested alteration in the federal tax. In the first year of the operation of the federal law, returns were made by individuals at their place of business. In the second year, the option was given of making the returns either at the place of business or at the place of residence. It would be a comparatively simple matter for the federal law to require a return of the state or states where the income was derived as well as of the legal residence of the recipient. This would afford an effective control of the returns. In a metropolis like that of New York, for instance, where a large part of the income earned within the city is received by non-residents, this problem is of special importance. Almost every important income tax in the world, it may be said, includes this double aspect of income.

It is obvious, however, that if we tax both incomes earned and incomes finally received within the state, some rule must be laid down as to the relative proportion to be taken by each taxing authority. We thus come to the second of the points mentioned above. So far as the income from real estate is concerned, the problem need not give us any trouble, for under the accepted principles of American jurisprudence and of justice the income from real estate ought to be apportioned to the state of its location. In the case of business incomes, however, some method must be devised for taxing only so much of the income as is actually received or derived within the state. It is here that we shall need some federal law, or some decision of the supreme court, in order to bring about complete uniformity. As a matter of fact, several states including New York already apply the principle in the taxation of corporations by utilizing the criterion of proportionate mileage or proportionate assets or proportionate capital employed within the state. And as long as the principle of allocation is accepted, the exact method of devising a practical scheme may safely be left to the future.

If, however, the suggestion is adopted, permitting municipalities to levy an additional income tax under state law, or

distributing to localities in general a percentage of the state income tax, it would become necessary to provide for a further apportionment of income within the states themselves. If New York City for instance, were to levy an additional income tax, the question would arise in the case of New York business men living in Westchester County, as to how much tax they should pay in New York. This should of course be a matter for state law to regulate; and almost any rough approximation to equality would be adequate. It might, for instance, be provided in the law that in such cases two-thirds of the tax should accrue to the place where the income is earned and that one-third should be handed over to the place of legal residence, or the distribution of the state tax to the localities might be on the basis of assessed valuation of real estate, which would have the great advantage of causing the localities to increase their assessed values, thus working in precisely the opposite direction from the state tax on property, which notoriously leads to under-assessment.

The third point adverted to above is the relation of individual and corporate taxation. Here again we see the necessity of the dual conception of income. If the income tax be conceived of simply as a tax on the ultimate recipient, no tax on corporations would be legitimate. On the other hand, if the tax be considered one on the source of the income as well, a tax on the income of the corporation as well as on the dividends received by the stockholder would be entirely legitimate if the corporation tax be regarded as an impersonal tax. Especially would this be true if the corporate income tax were extended to all business concerns. We should then have an impersonal tax side by side with a personal tax.

Whether the income tax should be applied to corporations in those states which already have a fairly successful system of corporation taxes is a matter open to debate. In New York State, for example, ordinary manufacturing corporations are to a large extent, under the practical construction of the law, exempt from state taxation. There is no compelling reason why they should not be subject to a state income tax under the conditions mentioned above. So far as the public-service corporations, however, are concerned, New York already derives a large revenue therefrom; and while there is no doubt that a reform of the state tax on corporations is entirely de-

sirable, it might be just as well, in order not to multiply difficulties, to exempt them from the income tax. All corporations, however, are still subject in New York to local taxation on their entire property tax. The complications connected with this as leading to the adoption of the involved franchise tax are well known. It would be a great step in advance if there could be substituted for this local tax on personal property a local income tax to be assessed by the state board and to replace the franchise tax as well. This would greatly diminish the objections on the part of local communities which now derive a substantial revenue from corporate taxes. That in New York as well as in many other states the corporation taxes, both state and local, will ultimately be put on an income basis, is scarcely open to doubt. But as to the tempo of development, there may be reasonable grounds for discussion.

It is obvious from what has been said that it would be in every way desirable to abolish entirely the taxation of personal property and to have the income tax serve as a substitute therefor. If this is an impossibility for political or constitutional reasons, it would be well to consider the plan already adopted in Wisconsin, namely, to permit the deduction of any taxes paid by individuals on personal property from the sums due for income tax. This would, indeed, still necessitate the form of property assessment; but the result would virtually be the same. Moreover, the privilege which has been suggested of permitting localities to choose an additional income tax for local purposes, to be levied by the state, would put it entirely within the competency of each city, town or village to decide whether it preferred a continuance of the old general property tax, or a substitution of the new income tax. We might even go further and, if a local income tax proved to be politically impossible, suggest that the municipalities be permitted, under general state regulation, to select as a substitute for the personal property tax an indirect income tax in the shape of a habitation and an occupation tax.

The adoption of some such plan, it will be recognized, will also accomplish all that is desirable in the plan of separation of sources. The controlling reasons for suggesting the separation of state and local revenue have always been to relegate the taxation of real estate to the localities and to provide for a centralized state administration of taxes on corporations,

inheritances and the like. The adoption of a state income tax would really be in harmony with this scheme of separation; for real estate would be exclusively taxed by the local communities, while corporations and inheritances would be assessed by the state authorities. The mere fact that the income tax might be utilized for both state and local purposes would in reality not derogate from the principle involved. For the basis of the tax would still be a state basis, even though additions were permissible to the localities. Such a system should not be deemed inimical to the real principle underlying the theory of separation of source, any more than the existing apportionment of the mortgage recording tax in New York or of certain corporation taxes in other states ought to be deemed inimical to the principle. Separation of source properly conceived, means primarily separation of the assessment of source.

From the above review it will be seen that we are slowly but surely being pushed into a position where property is to be replaced by income as the chief basis of taxable ability. If in New York public opinion is not yet ready to declare itself in favor of such a revolution as is implied in the income tax, it is entirely likely that we shall proceed for a time to follow the plan pursued for over a century by France, when she abandoned her old personal taxes—that is, of attempting to reach the income indirectly rather than directly by a series of taxes on things rather than on persons,—such as habitation taxes, occupation taxes, business licenses and the like. For with the increasing burdens of modern life, it is fair to assume that real estate alone will not be permitted to endure the pressure. Until the recent adoption of the federal income tax, the outlook for a successful state income tax was exceedingly slight; now, however, the situation is entirely altered, and is full of promise.

There are only two points that we should like to emphasize in closing. The one is that if we are to utilize the income tax as a promising source both of greater revenue and of greater equality for state and local purposes, it is important that the rate of the income tax should be kept low. For if there should be a real competition between the federal and the state governments for the same source of revenue, the results could only be disastrous. This leads to the second point, that it behooves us to take up anew, and from a broader point

of view, a reconsideration of the relative merits of direct and indirect taxes. With the well-nigh exclusive reliance of the states upon direct taxation, and with the growing tendency on the part of the federal government to emphasize the prevalence of direct taxation, there is a grave danger of our overstepping the limit. All history has shown that a certain balance must be kept between direct and indirect taxes. As the great reformer Gladstone told us over a half a century ago, we must think of direct and indirect taxation as two attractive sisters, with the same parentage (necessity and invention), differing only as sisters may differ, in minor respects, and not justifying any unfriendly rivalry between their admirers. We are in danger of losing that sense of impartiality, which so strongly animated that great statesman. We need in the domain both of federal and of state taxation to devote considerably more attention in the future to the possibilities of indirect taxation. For we shall otherwise not only complicate the situation but incur the danger of a serious reaction from the ensuing exaggerated burden of direct taxation; and shall render still more difficult this transition from property to income taxation which is impending in many of our states and which we have ventured to call the next great step in advance.[1]

[1] The plan suggested in 1915 in the above address was carried out in all its important features within a few years in New York. In 1917 the income tax was applied to corporations in the so-called Emerson Law; and in 1919 to individuals. In Massachusetts, where much the same arguments were applicable, the sequence was the opposite: the personal income tax was introduced in 1916, the corporate income tax in 1919. For an admirable account of these see the monograph by Professor Alzada Comstock: *State Taxation of Personal Incomes.* New York, 1921 (*Columbia Studies in History, Economics and Public Law*).

CHAPTER XXI

THE RELATIONS OF FEDERAL, STATE AND LOCAL REVENUES [1]

I. *The Problem*

It is only in modern times that the fiscal inter-relations between central and local governments have become of importance. In ordinary states the question is one of divergence between national revenues and local revenues. In federal states the problem is further complicated by the interposition of the commonwealth or state between the federal or national government on the one hand and the local government on the other.

Government revenues are the counterpart of government expenditures, and these depend primarily upon the character and the extent of government functions. From this point of view, the fiscal relations in question are of considerable complexity. All expenditures were originally local in character. Economic life was at the outset based upon a local economy, and what little money was spent was both raised and expended primarily for local purposes. It was only when the national state developed as a result of the profound economic changes of the later middle ages that national expenditures now appeared on the scene, and especially for the purposes of the army and the navy. Somewhat later there came a two-fold development as a consequence on the one hand of trade and commerce and on the other of democracy.

Trade and commerce were responsible for the growth of expenditures connected with transportation, and especially with

[1] The earlier part of this chapter is based upon a paper read before the Second Pan-American Congress in Washington, December, 1915, and published in the *Proceedings of the Second Pan-American Scientific Congress*, vol. xi. 1917,—pp. 79–87. The latter part of the chapter is based upon the "Report of the Committee on the Relations of State and Federal Taxation" made to the New York State Tax Association in 1917 and published in the *Addresses and Proceedings, Seventh State Conference on Taxation*, Albany, 1917, pp. 26–49.

good roads. Although this was accomplished in part by the localities, more and more supervision was exercised by the central governments, so that the expenditures of the central government for such purposes now grew to considerable proportions. The same was true still later when, as in France, the construction of canals called for large outlays. The result of the movement down to the beginning of the nineteenth century was that the great burden of expenditure resting upon the individual was primarily for the purposes of the central government, and that even in England the local expenditures were limited in large measure to the care of the poor, with very slight addition as for roads and other miscellaneous purposes.

At the beginning of the nineteenth century, the democratic movement, which was the result of the industrial revolution, altered the situation in two ways. In the first place, there now came a rapid increase of expenditures for education, for improving the health and sanitation of the community and, finally, for developing the general welfare in its still wider aspects. In the second place, these expenditures were overwhelmingly local in character, although there has also been a tendency of late for the central governments to assume to an increasing extent some of the same functions. The consequence has been that, on the whole, in the most recent period local expenditures have become in many ways quite as important as, even if not more important than, the central expenditures.

While there has been this general movement, the situation has been complicated by the fact that government functions and expenditures have been variously apportioned in different states. In some states certain functions have been gradually relegated to the local communities; in others, the contrary is the case.

In the Anglo-Saxon communities, there has been a growing tendency for a central control over the local functions of government; in others, as in France and Italy, there has been a tendency toward a greater decentralization. Moreover, in all federal states a further complication has been introduced in that in the separate commonwealths or states that stand between the localities and the federal government there has been a mixed movement both toward centralization and toward decentralization; so that in some communities the one tendency

preponderates, in other communities the contrary. In the United States, for instance, the states have been gradually assuming the control of several functions that were originally left to the localities, as in the case of highroads, hospitals, asylums, state constabulary, and the like. On the other hand, the states have been losing some of their functions to the central government, as in the case of the growing federal control over railroads and various forms of business enterprises; and we now hear insistent demands for a federal quarantine, and for federal control of labor conditions. As a consequence, there is at present no clear-cut line between federal, state and local functions and expenditures.

Since the revenues of government stand in a certain relation to expenditures, the same difficulties that have arisen in the case of expenditures reappear in that of revenues. In fact, there are even more complications in revenue than in expenditure because of the possibility, as we shall see, of expenditures by one form of government being defrayed out of the revenues derived in part or in whole from another form of government. The whole subject of public revenues is therefore bound up with the problem of a proper relation between central and local finance, or in the case of federal governments between federal, state and local finance.

As a preliminary to a discussion of the fiscal relations of central and local governments, it is necessary to recall the two controlling principles of public revenues. These, as is well known, are, on the one hand, the principle of ability to pay and, on the other hand, that of benefit conferred. It need not be pointed out that the latter was the one long accepted by publicists, and it is only in recent times, with the emergence of modern democracy and with the insistence on the specifically social aspects of public finance, that the principle of ability to pay has come to the front. The most recent analysis of the subject, however, discloses the legitimacy of both principles, although it is careful to relegate each principle to its proper sphere. It is now well understood, for instance, that taxes in general must be framed and apportioned according to the principle of ability to pay; while most of the remaining categories of public revenues, such as fees, special assessments, and prices of all kinds for governmental services conform to the principle of benefits conferred or cost incurred.

While this demarcation is now generally accepted, it is none

the less true that there is a certain border line or zone of indifference. Certain taxes like some imposts on land can be upheld almost as well on the principle of benefits as on that of ability to pay; while other payments, like inheritance taxes, which in some countries (like the United States) are legally included under the head of payments made for benefits or privileges, correspond in reality to the principle of ability. Without attempting to pursue further this inviting line of inquiry, it is sufficient for our purpose to point out that there is a jurisdictional division corresponding roughly to the above division in principle; that is to say, the chief home of revenues predicated on the principle of benefit is to be found to-day in the local divisions, while the chief home of revenues based on the principle of ability to pay is to be found in the more central governmental jurisdictions. The line is, indeed, not entirely sharp; for we find, on the one hand, some fees levied and not a few industries or enterprises conducted by central governments; while, on the other hand, certain local taxes are to be explained primarily on the principle of ability to pay. But as a general principle it is true that there exists in most countries to-day a larger field for the principle of benefits in the localities, and a larger field for that of ability to pay in the central jurisdiction.

II. *The Five Methods*

If we turn to an analysis of the actual conditions to be found in the fiscal relations of central and local governments and if we confine our attention to what is the most important part of the subject, viz., the revenue from taxes and primarily from taxes which may be upheld on the principle of ability to pay, we shall see that there are no less than five different methods actually employed. These are as follows:

(A) The taxes are assessed by local authorities, with additions for the use of the central government. This is the common method in the American commonwealths, where the local revenues are derived, to an overwhelming extent, from the general property tax, levied upon real and personal property alike. The rate of the tax for purely local purposes is ordinarily arrived at by dividing the assessed valuation of the property in the locality by the amount to be raised for local purposes. To this local rate there are added rates for county

as well as for state purposes, each of which is ascertained by dividing the assessed valuation of the property in the locality by the amount needed for the expenses of the county and of the state respectively. The same tax, assessed by the local officials—*viz.*, the general property tax,—is thus utilized for both local and central purposes.

(B) The tax is assessed by the central authorities with additions for local purposes. This is the reverse of the system last mentioned. It was, until the great reforms of 1917–1920, to be found in France, whose example has been copied in not a few states. In France there were four taxes levied for state purposes: the land and buildings tax, the *patentes* or business tax, the *personelle et mobilière* or personal tax, and finally the door and window tax. The local revenues were obtained by adding a certain percentage, known as the *centimes additionels*, to each of these state taxes. There were, indeed, other revenues, chiefly from indirect taxes for state purposes, and from the *octrois* for local purposes; but the fact remains that so far as the bulk of local revenues is concerned, they were derived from this simple addition to the direct state taxes. Under the new régime, where the four impersonal taxes have been replaced by the income tax, the local revenues consist of *centimes additionels* to the state income tax.

(C) The separation of the sources of revenue; that is, certain taxes are utilized for central, and others for local purposes. This separation again is either total or partial. A partial separation is very common. Virtually all nations, for instance, reserve customs duties, whether import or export duties, for the central government. Many nations again reserve definite classes of indirect taxes for the central government. In the United States, for instance, there are only one or two exceptions to the general rule that the indirect taxes are devoted to federal purposes, in the shape of the Internal Revenue. The same is true, although to a somewhat slighter extent, of the German Empire. Even in regard to direct taxes, however, the principle of separation of source is not infrequently found. In Great Britain, for instance, the income tax is utilized for the nation, while the local revenues are derived almost exclusively from the local rates or real estate taxes. Again, in Germany, the so-called taxes on yield (*Ertrags-Steuern*), which correspond to the four direct taxes until recently levied in France, are, since the reforms of 1893–1895, reserved exclusively

for the local governments, although for the sake of better administration they are still assessed by the states. In the United States this tendency is also visible. In not a few commonwealths the inheritance tax and even the corporation taxes are now allocated to the state, while the local governments depend more and more upon the property tax. In New York this policy has been carried to such an extent that for a number of years during the first decade of the present century, it became unnecessary to levy any so-called direct or property tax as an addition to the local tax.

(D) The division of the yield; that is, the revenues are collected by the central authorities, but a portion of the yield is assigned to the localities. This is true of the so-called death duties in Great Britain, where a portion of the yield is reserved for the local divisions. An analogous condition prevails in some of the American commonwealths, where railroad or other corporation taxes are assessed and collected by the state governments, but are then returned in part to the local divisions. Conspicuous illustrations of a similar method are seen in New York in the income tax and the mortgage tax, the proceeds of each being divided equally between the state and the locality. The most striking example of this principle, however, is found in Germany where the law of 1920 puts the entire administration of the income, inheritance, land transfer (*Grunderwerbsteuer*) and turnover (*Umsatzsteuer*) taxes in the hands of the empire, and assigns a portion of the revenue to the states. This portion amounts to two-thirds for the income tax, twenty per cent for the inheritance tax, fifty per cent (and in a few cases twenty-five per cent) for the land transfer tax, and fifteen per cent for the turnover tax. In the last case five per cent must go to the localities; in all the other cases, the apportionment to the localities is left to the states.[1]

(E) The system of subventions or payments from the central to the local governments or from the local to the central governments. A notable example of the former system is to be found in Canada, where, as a result of the surrender by the separate provinces of the right to levy customs and excise duties, the Dominion transfers annually large subventions to the provincial treasuries. A similar system is in force in

[1] In 1923 these proportions were changed as follows: income and corporation tax 75%, increased in 1924 to 90%, motor tax 50%, turnover tax 10%, land transfer and race track taxes 100%.

Australia, since the constitutional amendment of 1910, as a result of which the Commonwealth, in return for the privilege of levying all customs and excise revenues, annually pays over to the separate states a fixed sum *per capita*. In all these cases the payments are made by the federal to the state government. In other countries, however, the reverse system obtains. During the period of the first Constitution of the United States the federal government was almost entirely supported by the so-called requisitions upon the states, and until recently the German empire was still very largely alimented by the so-called *Matricular-Beiträge*, or contributions made by the states.

In comparing these five systems, it is clear that the first and the last possess obvious disadvantages. One of the chief difficulties connected with the first system is that the utilization for general state purposes of a locally assessed tax on property inevitably leads to an under-assessment of the property. It makes little difference, for instance, whether for purely local purposes we have an under-assessment of property with a high rate, or a full assessment with a low rate. Since a definite amount of revenue is needed for local purposes, and therefore a definite amount of money must be taken out of the pockets of each individual, as long as the property of all individuals is assessed in the same proportion, it makes no difference whether we have a low or a high rate. As soon, however, as the assessment is utilized for state purposes, and the amount to be raised is made to depend upon the assessed valuation in the county or the locality, it is clear that the lower the local valuation, the less will be the aggregate amount which the locality will have to pay to the state. This is one of the chief causes which have led to the under-assessment of property in the American states, and it is largely for this reason that the movement is now so pronounced in the United States toward both a central supervision over local assessments and an abandonment of the local property tax for state purposes. The first method thus is clearly susceptible of improvement.

The fifth system, again, namely, that of subventions, is only a makeshift. To have the federal government depend entirely upon largesses from the states is to render it more or less impotent, and certainly to make it subordinate to the states. That was the result of the American system of requisitions, and was one of the reasons for the growing fiscal complexi-

ties of the German empire. On the other hand, to make the separate states depend financially upon the federal government is to weight the balance in the opposite direction and is not, in the long run, desirable in the interest of a complete equilibrium. The system of subventions is concededly a makeshift system, and in Australia it has therefore been limited to a period of ten years.

The third system, namely that of the separation of source, possesses some advantages. The first is the conformity with the natural division of governmental functions and activities. Certain activities of government are local, some are interlocal or state, and some are national. If the revenues can be made to conform to this natural division, so much will be gained. The second advantage is the securing of greater equality in the assessment of property, and especially of real estate, leading to the elimination of the unfortunate scramble for reduction of valuation in the localities. The third advantage, so far as concerns the relegation of the property tax to the localities, is a reduction to that extent of the direct taxation of property. The fourth is the removal of conflicts between the cities and the rural counties. The final advantage is the greater flexibility and adaptation of means to the end, whereby each locality may be better able to adjust its fiscal system to its own fiscal needs.

While these advantages are undoubted, we must be careful not to push the principle too far. If by separation of source we mean, as explained above,[1] the liberation of the state from dependence on the locally assessed property tax, there can be no valid objection to it. But if by separation of source we mean absolutely distinct sources of revenue for central and for local purposes, with no possibility of the state sharing some of its revenue with the localities, the project is by no means beyond criticism. For, as we have seen above, the line between local, state and federal functions of government is by no means always clear cut; and a complete separation of source might put into too bold a relief a division which does not exist in actual life. Moreover, a complete separation of source may sometimes introduce fiscal embarrassment. It may, for instance, happen that the particular source of revenue assigned to either the state, or the federal government may be more than adequate for its purpose, while the source assigned to the other jurisdic-

[1] *Supra*, p. 376.

tions may be inadequate. There seems to be no convincing reason why the surplus of the one kind of revenue should not be utilized to make good the deficit of the other.

In short, while there is much to be said for the principle of separation of source, correctly interpreted, we conclude that in the strict sense of the term it is in need of being supplemented by other principles in order to secure a well-rounded fiscal system.

We come, then, finally to the consideration of the second and the fourth systems, mentioned above as B and D.

The system of a centrally assessed tax with additions for local purposes has much in its favor, especially when the tax chosen is one with a broad base. A good example of such a system was the Prussian income tax, which was administered by the state, and where additions up to a certain percentage were permitted for the use of the localities. The advantage is that the individual in paying his tax bill gives a lump sum for both state and local purposes, and is relieved from the annoyance of separate returns. The same is true of the *centimes additionels* in France. The obvious danger, however, in such a system is that by using the same tax for both state and local purposes we run the risk of increasing the rate to such an extent as to interfere with its maximum productivity,—a danger inherent in any system which looks toward the singleness rather than to the multiplicity of taxation. With this warning, however, and on the understanding that the system must not be pushed to an extreme, much may be said for the above method of local additions to centrally assessed taxes, as supplementary to the other methods in vogue.

Finally, we come to the principle of division of yield. This is the obvious result of any particular source of revenue where the stream of income gushes forth so abundantly as to produce more than is needed for the purpose in hand, and where, conversely, there is a deficiency elsewhere. An example of this is afforded by the railway taxes in some American commonwealths. It is conceded that from every point of view it is preferable to have the assessment of railways in the hands of central authorities; for the experience of the American states with the local assessment of what is essentially inter-local or extra-local in character has been unfortunate. To take, however, the entire revenue of railways for state purposes would be in not a few cases to rob the localities of a share of what

they have been accustomed to rely upon; and it was, therefore, an easy transition to introduce the system of a state assessment and collection, with a repartition of at least a part of the yield among the localities. The same point of view is observable in the German inheritance and incomes taxes, where for administrative and fiscal reasons it was found desirable to levy them as federal imposts, but where the separate states which had been accustomed to depend upon those sources of revenue were able to prefer a claim to a portion of the yield.

In short, wherever it can be shown that a particular tax might well, on the basis of general economic considerations, aliment both the central and the local treasuries, there is strong reason for maintaining the principle of division of yield.

Our general conclusion from the above analysis is that, while the first and fifth methods are relatively indefensible, a combination of the second, third and fourth methods affords a reasonable ground for expectation of success.

III. *The Choice*

In deciding upon choice between, or a combination of, the above methods it is well to keep in mind certain fundamental principles. The three principles that should guide in the allocation of revenues as among various tax jurisdictions are: the extent of the base of the system, the efficiency of the administration, the adequacy of the revenue.

The extent of the base of taxation is obviously important. Some taxes rest, by their nature, upon the broadest possible base. The productivity of an inheritance tax for example depends upon the number and size of the assets of decedents. It is clear, however, that the smaller the area, the more variable will be the revenue. In a single town the death of one wealthy individual may swell the revenue from the inheritance tax in any one year to a point which may not be reached again for many years to come. This would be fatal to fiscal stability. A similar consideration would apply, although in a somewhat diminishing extent, as between state and nation in a federal government. The larger the area, the more regular the revenue.

Take, again, business or corporate activity, which originally was local in character but which has now become state and even national in character. Where the base is so broad, any

attempt to narrow the jurisdiction is fraught with peril. In the Middle Ages, for instance, a local or municipal tax on personal property was entirely feasible, because of the essentially local character of property. In modern times, however, the assets of a large business and the intangible character of much of the property have now become national or international in scope, so much so in fact as to render fruitless any attempt to reach that property by local methods; and the same consideration has led to the abandonment in recent years of any effort to levy a purely local income tax.

Secondly, the efficiency of the administration. Certain taxes like real estate taxes are specially adapted to initial local administration, because the assessment takes place under the eyes of the individual taxpayer. In many other cases, however, the farther away we get from local administration the better the chances not only of securing expert officials, removed from the dependence upon local prejudice, but also of making allowance for certain inevitable gaps in any local administration. When the administration, for instance, of the liquor license or excise tax in New York was transferred from local officials to the state administration, the revenue was largely increased. Again, if we have a system of state assessment of corporations, the difficulty arises not only as to the allocation of the due proportion of total revenues earned by the corporation, but also of knowing what to do with purely interstate revenues. In the case of the inheritance tax, where a part of the revenue has been based upon the principle of residence of the decedent, we cannot ignore the chance of evasion by transferring the legal residence to a state where the tax does not exist, or where the rates are lower. Finally, the history of the United States particularly has shown that a federal administration is often more efficient than the state administration. Compare, for instance, the results displayed in the construction of the Panama Canal with those shown in the construction and maintenance of the new highways in New York. The efficiency of central as over against local administration depends not only upon general political and administrative conditions, but also upon the constitutional and economic relations of certain revenues themselves.

Thirdly, the adequacy of the revenue in question must not be overlooked. In a certain jurisdiction which is already fairly well supplied with revenues, and where for reasons of greater

equality or expediency a new source of revenue is added, it not infrequently happens that the total is more than is needed; while, on the contrary, as again not seldom occurs, where this new source had previously been enjoyed by another jurisdiction, the situation may be the reverse. Take, for instance, the case of a tax on corporations, which up to that time had largely alimented the local budget and which now is transferred to the state, thus resulting in a possible deficit in the one case and a surplus in the other. Take, again, the development of the federal inheritance tax in the United States, where the competition is being strongly felt by the separate states. Such examples, which might easily be multiplied, indicate the need of a careful consideration of the principle of relative adequacy of the revenues.

The practical inferences from the above would, of course, differ in every nation. We shall limit ourselves, in closing, to a summary of the conclusions applicable at the present time to the United States. As the most contentious part of the subject has recently become the relations of state and federal finance, we shall begin with that.

Let us recall to mind the chief steps in the development of these relations.

In the period before the formation of our present constitution, the powers of taxation resided entirely in the separate states. The federal government, under the articles of confederation, had no independent powers of taxation. The failure of the efforts on the part of the federal government to secure from the states the power to levy import duties was in large measure responsible for the present constitution. Under the new constitution, the states abandoned to the federal government the power to levy import duties and, by implication, to levy taxes of any kind on interstate commerce as well. Both state and federal governments were also prohibited from levying export duties. The whole remaining field of taxation was open to the states and the nation, with the exception that certain conditions were imposed on the exercise by the federal government of the right to levy either direct or indirect taxes. That is, it was required that indirect taxes should be uniform and that direct taxes should be imposed under a rule of apportionment according to population.

When the new government went into effect, the states

alimented themselves from direct taxes on wealth—in the form of either the general property tax or taxes on special classes of property as well as from certain taxes on business and on polls. In a very few cases there were, in the Southern states, insignificant taxes in the shape of excises and taxes on transactions. Under the statesmanlike guidance of Alexander Hamilton, the federal government decided to derive its revenue not only from import duties—which were designed to constitute the leading source of income—but also from a combination of direct and indirect taxes lumped together under the head of internal revenue. So far as the indirect taxes were concerned, the revenue was derived almost exclusively from sources that were not utilized by the states; but in the case of the direct tax on lands, houses and slaves, which was levied in 1798, the principle was initiated of competition with the sources of state revenue. For, to the extent that the direct tax was levied on property as such, it was imposed upon the same objects that were already subject to state taxation. This is true also of the minor taxes on the sales of certain commodities and on legal transactions, in so far as these were found in a few of the southern states.

It is interesting to speculate what would have been the result in the United States had the Federalist policy been continued. As is well known, however, the political revolution which ushered in the Republican party brought with it also a fiscal revolution which settled the problem for over half a century. The new policy decided upon the abolition of all internal revenue taxes and made the United States dependent upon revenue from import duties alone. In this way the fiscal spheres of state and nation were kept entirely separate.

When the war with England broke out, the Republican party was compelled to revert to Hamilton's policy and to resort to a system of internal revenue, including all the old taxes, and, in addition, excises on commodities. Had the war continued a few months longer, there is no doubt that the sphere of direct taxation would have been greatly increased and that Congress would have accepted the report of the committee which had recommended the imposition by the federal government of an income tax, an inheritance tax, and a tax on such corporations as were of any importance at the time. But, with the sudden cessation of the war, not only did it

become unnecessary to levy these additional taxes, but it now became possible, in 1817, to abandon the entire system of internal revenue.

For almost half a century thereafter the United States depended exclusively upon the revenue from import duties; and so great was the increase of foreign commerce, that from 1830 on it became possible to reduce the rate of the tariff duties continually. With the outbreak of the Civil War, however, a new era was inaugurated and a comprehensive system of both direct and indirect taxation was adopted in order to supply the pressing needs of the treasury. This system, which included almost every possible kind of taxation, comprised among the direct taxes a tax on real estate, a general income tax, an inheritance tax and a tax on corporations.

By 1872, when the last of the war taxes was repealed, the country settled down to a new system of revenue on a peace basis. Ever since the advent of Jefferson, as we have learned, the federal government had relied, in peace times, exclusively on customs duties. It was now wisely decided to supplement the proceeds of the tariff by a system of internal revenue, consisting of taxes on a few, but important, articles of wide consumption. For over a generation this remained the settled policy of the United States, interrupted only by the temporary necessities of the Spanish War, when recourse was again taken to a more comprehensive system of indirect taxes and to certain direct taxes as on inheritances and corporations which, under our peculiar system of constitutional interpretation, were classed legally as indirect taxes.

The third stage in the fiscal policy of the United States was inaugurated in 1909. There was now added to the revenue from customs duties and internal excises a tax on corporations, legally classified as an excise tax, but from the economic standpoint, of course, a direct tax. To this there was added, in 1913, an income tax and, in 1916, an inheritance tax. Even without the outbreak of the Great War there seemed to be every prospect of an augmentation of these taxes in the near future.

To recapitulate, the fiscal policy of the United States in peace times may be divided into four periods. In the first or Federalist period, the national revenues were derived from both indirect and direct taxes; in the second period, dating from 1801 to the Civil War, tax revenues were limited, except during the War of 1812, to those from customs duties exclu-

sively; in the succeeding period, for a generation after the Civil War, a limited number of lucrative indirect taxes on commodities were added to the tariff duties; and finally, in the period beginning with 1909, the indirect taxes on commodities were supplemented by direct taxes.

Thus in our fiscal system, as in so many other matters, the country was now, after the lapse of a century, reverting to the Hamiltonian policy of government. But it is to be noted that at the close of the first decade of the present century there were two important facts which distinguished our condition from that which existed at the close of the 18th century. The first is that in the Hamiltonian system the direct taxes were a minor factor in comparison with the indirect taxes; whereas, now, the tendency now seemed to be the other way and the indirect taxes--both import duties and internal revenue—were being subordinated to the direct taxes. The second and more important point is that, in the interval, the fiscal situation of the states had entirely changed, so that the problem of the relation of federal and state finance, which scarcely existed in Hamilton's time, has now assumed important dimensions.

In the beginning, and for a long time, the fiscal needs of the separate states were insignificant. The expenses were very slight and the revenues were derived largely from fees and other miscellaneous sources. When Secretary Wolcott made his famous report on state taxes, in 1796, he disclosed the fact that of the total annual expenditures in Massachusetts of $145,531 only $25,682 needed to be derived from taxes; while in the state of New York there had been no need of taxation at all, except for local purposes, for a number of years, the last state tax, which was levied only very rarely, having been imposed eight years before and amounting to an insignificant sum designed to last for several years. What Secretary Wolcott referred to is only direct taxes. As a matter of fact, however, as we learn from a contemporary document,[1] of the total New York revenue in 1796 of $144,247 all was derived from the interest on investments or loans, except $31,295, which sum came from the duty on "sales at vendue." In Virginia the taxes were somewhat more regular, but still very insignificant. It may be stated, therefore, as a general proposition, that there was virtually no problem of state taxa-

[1] *Remarks on the Revenue of the State of New York.* By Philip Schuyler, a member of the Senate of that state. Albany, 1796, p. 6.

tion and that the federal government was not seriously embarrassed in its choice of revenues by any considerations affecting state finance.

In the interval up to the Civil War the situation changed only slowly. In some of the older commonwealths, the needs of state revenue slowly increased and were met by low property taxes in the northern and middle states, supplemented in the south by a system of license taxes. As corporations developed, toward the end of the period, they were included within the scope of the property tax and in a few sporadic cases, some insignificant inheritance taxes were added.

After the Civil War, however, the expanding functions of state government increased the need of state revenues in the older commonwealths, and with the consequent need of higher rates of taxation the old system gradually broke down. What took place in New York during the last quarter of the nineteenth century was slowly duplicated in the other more industrial states; and after a decade or two, the movement finally reached the more agricultural states, so that at present even the less progressive southern states are in the position where New York was forty years ago. This movement can be summarized as follows: the states' needs have multiplied; the rates of the general property tax have increased enormously; the general property tax has, largely for this reason, broken down as the chief source of commonwealth revenue; personalty has slipped out of the assessment lists; and all manner of inequalities have crept in. With the relative diminution of the yield of the property taxes the states first took recourse to special corporation taxes. Secondly, beginning as early as the '80's, they developed a system of inheritance taxes—first collateral, then direct on personal estate, and finally, a general inheritance tax. When even these sources no longer sufficed, an attempt, still in process of development, was made to replace the old and now unworkable tax on personal property either by special taxes on certain forms of personalty or, somewhat later, by a system of income taxes.

The remarkable change in the relative importance of state and federal finance will be realized when we remember that whereas in 1796 the total revenue from federal taxation was over 7 millions, the tax revenue of New York state amounted to only $31,000; but that in 1917, whereas the expenditures of the United States, exclusive of postal service, were $1,088,176,000

the expenditures of New York were over 77 millions. In fact the state expenditures alone were now one-half those of the national government.[1]

So prodigious are the continual increases in state expenditure that the problem of meeting them wisely becomes one of growing difficulty. It is hopeless to think of solving the problem by reducing expenditure. Much waste and extravagance can of course be eliminated by more improved accounting methods and, more especially, by the adoption of a modern budgetary system. But the prospect of steadily mounting expenditures led to a decided feeling in not a few commonwealths that unless the nation ceased to reach out into what was more or less rightly conceived to be the preserves of the states, serious embarrassment would arise, until the states would ultimately find it almost impossible to keep pace with their advancing needs.

The outbreak of the Great War has, however, revolutionized the situation. So stupendous was the cost that for an indefinite future the national expenditures, bequeathed by the conflict, will greatly exceed all the state and local outlays. Whereas in 1913 (the last general census year) state and local expenditures were about twice as large as those of the national government, in 1919 the national expenditures were (and promise to continue for the future) far larger than the state and local expenditures combined.[2]

The problem of taxation has thus become primarily a national problem; and, as a consequence, the greater part of the national revenues will, in conformity with democratic

[1] The total for all the states in 1917 was $517,503,220. *Cf. Financial Statistics of States, 1917.* 1918.—p. 67.

[2] The figures of expenditures are as follows:

For 1913 the total was $2,799,000,000 divided into:

Nation	$953,000,000	Municipalities (over 2,500)	$1,108,000,000
State	377,000,000	County,	370,000,000

For 1919:

State	$640,000,000	Municipalities (over 2,500)	$1,233,000,000

Adding another half billion for the probable county expenditures, on which we have no intercensal statistics, makes a total of about $2,500,000,000, as over against more than five billions, of national expenditures. The estimates for 1922 run over four billions.

instincts, have to be derived from direct taxes. The old time indirect taxes, even though necessarily stretched to the very limit of endurance, will accordingly henceforth have to be regarded as a supplementary resource. The consequence is that while the national government will no doubt in the future, as in the past, monopolize the customs duties and other indirect taxes, it will have to levy a far larger amount of direct taxes than will the states and localities. This is a not undesirable result because both the income and the inheritance tax rest on so broad a base as to make their utilization by the federal government desirable.

The question then arises, what is left for the separate states and localities? The states, it is clear, should rely chiefly upon corporation taxes, upon special taxes on property, and upon license and business taxes. Where these do not suffice, and an increasingly successful endeavor is made to abolish the inadequate general property tax, the states should rely, in addition, upon a part of the inheritance tax to be assessed by the federal government and finally upon income taxes, which should be supplementary, and as far as possible conformable, to the federal income tax.

The reason why a distinction is made in the suggested assessment of these two taxes is that the problem of residence is more easily solved in an income tax than it is in an inheritance tax; for the inheritance tax is really a tax upon the estate of a decedent, while the income tax may be so arranged as to include a business tax as well as a tax upon the individual. In either case, however, and irrespective of the jurisdiction which assesses the particular tax, some American states will no doubt, to an increasing extent, depend upon both the income and the inheritance tax.

Finally, local governments should rely primarily upon revenues referable to the principle of benefits, such as special assessments and fees of all kinds, which should be better regulated by state law; upon the tax on real estate and especially upon land taxes; and, so far as further revenues are needed, as a substitute for the unworkable personal property tax, upon additions to the state income tax.

It is not unlikely that the problem of fiscal interrelations will be solved in this general direction in the United States; for the solution is in harmony with the fundamental principles that have been presented above. In other countries, the practical

aspect of the solution will no doubt be different; but it is safe to say that throughout the world the trend of adjustment in the fiscal relations of federal, state and local governments will be found to be in line with the solution that has been sketched above.

NOTE TO 10TH ED. For recent literature on this topic see A. Hensel, *Der Finanzausgleich im Bundesstaat*, Berlin, 1922; Viktor Steiger, *Der Finanzausgleich zwischen Bund und Kantonen*, Bern, 1923; and B. R. Ambedkar, *The Evolution of Provincial Finance in British India*, London, 1925.

CHAPTER XXII

THE WAR REVENUE ACTS

THE war revenue act of October 3, 1917, possesses the distinction of being the most gigantic fiscal enactment in history. Never before has an endeavor been made to provide in a single measure for so colossal a revenue as is sought to be obtained by this law. In the following pages we shall attempt, after a short historical introduction, to give a summary of its principal features, an estimate of the tax burden involved, a statement of its probable distribution, and an interpretation of the novel and significant contributions made by the measure to public finance.

I. *Historical Retrospect*

The history of our war finance begins with the emergency-revenue law enacted shortly after the outbreak of the conflict and two and one-half years before our entrance into the war.

This history, however, cannot be understood unless we remember the change in the theory of federal revenue that had occurred in the preceding five years. From the early seventies of the last century, when the country had settled down after the fiscal upheaval occasioned by the Civil War, the federal income had been derived from customs and internal revenue taxes levied almost exclusively on liquors and tobacco. In 1909 this complete reliance upon indirect taxes was altered by a tax on corporations, called an excise tax in order to bring it safely

[1] This chapter is reproduced with a few changes from the article originally published in the *Political Science Quarterly* for March, 1918, vol. xxxiii., pp. 1–37, which deals with the Act of 1917. In the notes as well as the appendices to the present chapter attention is directed to the changes made by the second great war revenue act, which is generally spoken of as the Act of 1918, although if did not formally receive the assent of the President until Feb. 24, 1919. A separate treatment of this act, which made no fundamental changes in principle, will be found in R. M. Haig, "The Revenue Act of 1918," *Political Science Quarterly*, vol. xxxiv. (1919), pp. 369–391.

within the constitutional inhibition. After the passage of the Sixteenth Amendment, however, the corporation tax was merged in 1913 into the general income tax, which now marked the definitive adoption of direct taxation as a regular part of the national revenue. Recent events have only served to confirm the wisdom of those who argued that, from the point of view of possible warfare alone, it would be the height of folly to deprive the government of a great nation of such a potent engine. Without the Sixteenth Amendment we should have been deprived not only of the present income tax but, in all probability, of the present excess-profits tax as well.

The Act of October 22, 1914, entitled "An act to increase the internal revenue and for other purposes," was popularly known as the emergency-revenue law and was so termed in various official documents. The financial disorders which followed the outbreak of the war so seriously affected current revenues that an addition was imperatively needed. This was provided by four series of taxes: first, the increase of the tax on beer from $1 to $1.50 a barrel, together with slightly higher taxes on certain wines; second, the so-called special taxes on tobacco dealers and manufacturers, on bankers, brokers, commission merchants, and proprietors of public amusements; third, schedule A, comprising a variety of stamp taxes on transactions, as well as a tax on telegraph and telephone messages, express and freight rates, and Pullman fares; and finally, schedule B, consisting of stamp taxes on toilet articles and chewing gum.[1]

The additional revenue thus secured was about $52,000,000. That it was needed is obvious from the fact that the ordinary internal revenue, as appears from the table on the next page, fell from 308 millions in 1914 to some 283 millions in 1915. Moreover, owing to the increased yield of the income tax, as a result of the business recovery, the total internal revenue for 1915 was over 410 millions as compared with 380 millions in 1914.

The operation of the law was limited to the period ending December 31, 1915. It was so apparent, however, that the emergency was growing more serious, that Congress by joint resolution of December 17, 1915, extended the operation of the law to the close of 1916. The prosperity of the country consequent upon the filling of the Allies' orders for munitions and food resulted in an addition of almost a hundred millions to the internal revenue during 1916, the emergency revenue now

[1] For details *cf.* Tables I, III and IV, *infra*, pp. 708–712

yielding over 84 millions and the income tax providing almost 125 as against the 80 millions of the preceding year.[1]

The political sky became so lowering during the spring and summer of 1916 that even this increase seemed entirely inadequate. The consequence was the enactment, after considerable discussion, of the law of September 8, 1916. This act, entitled, like its predecessor, "An act to increase the revenue and for other purposes," repealed all the taxes imposed by the emergency-revenue law except the so-called special taxes which were to continue until the end of the year. The chief feature of the new law was the increase of the income tax, the normal rate being raised to 2 per cent and the scale of progression being made sharper.[2] Next in importance were the changes in the taxes on tobacco and liquors, the rates on tobacco and beer being made about the same as in the emergency-revenue law of 1914, while the rates on spirituous liquor were somewhat increased. Two new taxes were added, the estate tax, graduated

[1] INTERNAL REVENUE AND CUSTOMS RECEIPTS (IN MILLIONS OF DOLLARS)

	1914	*1915*	*1916*	*1917*
Spirits	$159.1	144.6	158.7	192.1
Tobacco	79.8	79.9	88.	103.2
Fermented Liquors	67.1	79.3	88.8	91.9
Oleomargarine	1.3	1.7	1.5	1.9
Miscellaneous	.9	1.5	1.7	2.
Special Taxes		4.9	6.9	15.7
Schedule A		20.5	38.1	8.3
Schedule B		2.9	4.1	.7
Estate		.....	......	6.
Munitions		.....	......	27.7
Excess Profits		.....	......	.037
Miscellaneous	1.1	1.5	1.7	2.1
Total of above items	308.6	335.5	387.8	449.7
Ordinary	308.2	283.4	303.5	354.4
Emergency		52.	84.4	95.3
Income	71.4	80.2	124.9	359.7
Corporation	43.1	39.1	56.9	179.6
Individual	28.3	41.	67.9	180.1
Total Internal Revenue	380.	415.7	512.7	809.4
Customs Duties	292.3	209.8	213.1	225.9
Total Tax Revenue	672.3	625.5	725.8	1,035.3
Total Ordinary Receipts	743.7	697.9	779.7	1,118.2
Total Receipts (including Postal Revenue)	1,002.6	985.2	1,091.7	1,447.9

[2] See Appendix, Table V, *infra*, p. 713

from 1 per cent to 10 per cent, and the munitions manufacturers' tax, the duration of which was limited to one year after the close of the war. This was a so-called excise tax, over and above the income tax, of 12½ per cent upon the net profits of manufacturers of gunpowder, cartridges, projectiles, firearms and motorboats, including submarines. Finally came a series of so-called special taxes, limited, with one exception, to manufacturers of tobacco, brokers, and proprietors of public amusements. The exception consisted in an excise tax on corporations, joint stock and insurance companies, amounting to 50 cents for each $1,000 of the value of the capital stock over $99,000. The act also provided for changes in the import duties on dyestuffs and printing paper, and brought into existence the new tariff commission.

The Act of 1916 was expected to yield an additional revenue of several hundred millions. During the early months of 1917, however, the political situation became so acute that Congress decided to make provision for the imminent conflict by creating the so-called special-preparedness fund, to be used only for military and naval preparations. This was accomplished by the Act of March 3, 1917, entitled, "An act to provide increased revenue to defray the expenses of the increased appropriations for the army and navy and the extensions of fortifications and for other purposes." The fund was to be alimented from two sources: the excess-profits tax and a considerable addition to the inheritance tax. The excess-profits tax consisted of 8 per cent of the amount by which the net income of every corporation and partnership exceeded the sum of (a) $5,000 and (b) 8 per cent of the actual capital invested. The law did not apply to corporations exempted from the income tax or to partnerships carrying on similar businesses or deriving an income from agriculture or personal service. The estate tax was so altered that the new rates were graduated from 1½ per cent to 15 per cent.[1]

The two acts resulted in a substantial increase of the revenue in 1917. Only an insignificant amount, however, was obtained from the excess-profits tax[2] and only about six millions from the estate tax. But the munitions manufacturers' tax yielded about 28 millions, and the ordinary internal revenue about 60 millions additional, while the income tax rose from 125 to 360 millions, so that the total internal revenue for 1917 was over

[1] See table, *infra*, p. 714. [2] See table on preceding page.

809 millions or, roughly speaking, somewhat more than double the pre-war yield under ordinary business conditions.

Immediately after the declaration of war in April, 1917, preparations were rushed, and vastly augmented appropriations were made. That a prodigious increase in the revenue would be needed was apparent, but exactly how much would be necessary, no one knew. The Treasury Department refrained from making any exact estimates and when the present writer stated [1] that the expenditures would amount to at least ten billions, his assertions were greeted with a smile of incredulity. It soon appeared, however, that this calculation was well within the truth, and preparations were made by Congress to finance the war on that assumption. After the revenue bill had come to the Senate Committee on Finance, a revised list of probable appropriations for 1918 was submitted, bringing the total to nineteen or twenty billions. This unexpected change called for a complete recasting of the bill, and led, after a protracted discussion in the conference committee, to the passage of the Act of October 3, 1917.

II. *Summary of the War Revenue Acts*

The law is entitled "An Act to defray war expenses and for other purposes." All the new taxes are to be superimposed upon the existing system, except that the old excess-profits tax is repealed and the munitions manufacturers' tax is lowered to ten per cent, and is to cease entirely after January 1, 1918.

The backbone of the law, arranged in thirteen [2] titles, consists of the new income and excess-profits taxes, each of which will be discussed separately later on. The remainder of the law provides for a great variety of imposts.[3] The most important is Title III,[4] the war tax on beverages, which includes an additional tax of $1.10 per gallon on distilled spirits produced, im-

[1] *How to Finance the War*, Columbia War Papers, no. 7, p. 6.

[2] Changed in the law of 1918 to fourteen.

[3] In the Appendix, pp. 708–714, are printed a series of tables, not to be found in any of the official publications, showing the details of the old rates, the changes due to the various war acts, and the existing rates.

[4] In the law of 1918 this became Title VI. The taxes on distilled spirits for beverage purposes and for fermented liquor were doubled and a new tax was levied on cereal beverages as well as on soft drinks and ice cream when sold at retail. The producer's taxes on soft drinks were greatly increased!

ported or in bond, and of $2.10 if withdrawn for beverage purposes. As the further production of such spirits was stopped by the Food Administration Act of August 10, which prohibited during the war the use of grain for distillation, the result is that all existing stocks are subject to the high tax of $3.20 a gallon. The law imposes a further tax of 15 cents a gallon on rectified spirits, while the rates on wines and cordials are doubled, and on grape brandy, trebled. More moderate taxes are imposed on soft drinks and mineral waters as well as on the syrups, extracts and gas used in their manufacture.

Title IV,[1] dealing with tobacco, imposes an additional tax varying per thousand, on cigars from 25 cents to $7 and on cigarettes from 80 cents to $1.20, and fixed on tobacco and snuff at 5 cents a pound. In the case of more than 100 pounds of tobacco or 1,000 cigars or cigarettes, subject to the old tax but removed for sale before the thirty days when the new law goes into effect, the additional tax—known as the excess-quantity tax—is to be at half rates. A new tax, varying from ½ cent to 2 cents per package or tube, is imposed on cigarette paper.

Title V,[2] "the war tax on facilities furnished by public utilities and insurance," assesses freight rates 3 per cent; express 1 cent for each 20 cents of charge; passenger fares, 8 per cent; Pullman tickets, 10 per cent; pipe-line transmission, 5 per cent; telegraph, telephone, and radio messages (of 15 cents or more) 5 cents; marine, inland, fire and casualty insurance, 1 per cent on the premium; and life insurance 8/10 of 1 per cent on the amount of the policy. In the case of insurance the tax is to be paid by the issuer of the policy, in all other cases it is provided that the tax shall be paid by the person paying for the service.

Title VI,[3] the "war excise taxes," charges automobiles, mu-

[1] In the law of 1918 this became Title VII. The taxes on tobacco were increased on the average about fifty per cent, with the exception of the tax on cigarette paper.

[2] In the law of 1918 the name of this title became a Tax on Transportation and other Facilities and on Insurance." The rates on Pullman tickets were reduced and on pipe-line transmission increased, to 8%. Telegraph and telephone messages were taxed 5 and 10c. according as the cost was under or over 50c. Leased wires now also paid 10% of their rental.

[3] In the law of 1918 this became Title IX as "Excise Taxes," and included many new taxes. Twenty classes of commodities were now subjected to a retail tax of 10% on the amount in excess of a certain price, thus becoming virtually luxury taxes. The tax on automobiles, musical instruments, jewelry was increased to 5% and on perfumes, cosmetics, etc., to 4%, while the tax on moving-picture films was changed to a 5%

sical instruments, jewelry, sporting goods and games, chewing gum and cameras, 3 per cent; cosmetics, toilet articles and patent medicines, 2 per cent; moving-picture films, ¼ to ½ of 1 cent per foot; and motorboats and yachts from 50 cents to $2 per foot. In the case of the last item, the tax is imposed upon the user; in all the other cases upon the manufacturer, producer, or importer. No change is made in the old excises or "special taxes."

Title VII,[1] is the war tax on admissions and dues. On admissions where the charge is over 5 cents (or in the case of outdoor parks, 10 cents) the tax is 1 cent for every 10 cents of charge. Children under twelve pay only 1 cent and the tax is remitted in the case of religious, educational, or charitable institutions or agricultural fairs not conducted for profit. On dues or membership fees over $12 of social, athletic, or sporting clubs, the tax is 10 per cent.

Title VIII,[2] "the war stamp taxes," includes a variety of imposts on bonds, conveyances, entries, proxies, and powers of attorney; on the issue and transfer of capital stock; on transactions on stock and produce exchanges; on promissory notes and time drafts; on playing cards, passenger tickets over $10, and parcel-post packages.

Title IX [3] imposes an additional "war estate tax" varying from ½ of 1 to 10 per cent. This resulted in the inheritance tax being graduated up to 25 per cent on sums over ten million.

Finally, title XI [4] adds 1 cent to the rate on postal cards and other first-class mail with the exception of drop letters, in which no change is made. In the case of second-class mail a distinction is introduced between the space devoted to reading matter and to advertisements. In the former the existing rate

rentals tax. Sixteen new classes of commodities were now subject to a tax paid by the producer on the basis of the wholesale tax, the rates being generally 5% to 10% (with the single exception of 100% on daggers and stilettos). The fiscally most important taxes were those on articles of fur and candy. Finally the tax on the use of motorboats and yachts was increased to a maximum of $10 and was removed from this title to the new Title X mentioned below.

[1] In the law of 1918 this became Title VIII. The only changes were a scalpers' tax on the increase of price charged, and the taxation of club dues in excess of $10, instead of $12.

[2] In the law of 1918 this became Title XI, the only change being the increase of the tax on playing cards to 8c. a pack.

[3] In the law of 1918 this became title IV. The only changes were a more regular progression in the lower classes.

[4] In the law of 1918 the additional postal charges were dropped.

of 1 cent a pound is increased to 1¼ cents from July 1, 1918, and to 1½ cents after July 1, 1919. In the case of the latter, the rates up to July 1, 1919, vary from 1½ cents in the first and second zones to 3¼ cents in the eighth zone; in the succeeding year they are to run from 1½ to 5½ cents respectively; in the following year from 1¾ to 7¾ cents, and after July 1, 1921, from 2 to 10 cents.[1]

III. *The Tax Burden and its Distribution*

In considering this code of taxes—for it is nothing less than a code—the first questions that present themselves relate to the expected yield of the system, the relative proportion between loans and taxes, and the distribution of the burden.

According to official estimates the probable yield[2] of the

[1] The act of 1918 contains an additional Title X called Special Taxes which changed the special excise tax on corporations as originally levied in 1916 to one per mill on capital stock with a deduction of $5,000 for domestic corporations. The special taxes on manufacturers of cigars, cigarettes and tobacco were greatly increased and twelve new classes of special taxes were imposed on various kinds of brokers, and of public exhibitions or shows, bowling alleys, billiard rooms, shooting galleries and riding academies, on operating automobiles for hire and on breweries, distilleries, and retail and wholesale liquor dealers or dealers in malt liquor. The tax on motor boats and yachts, now increased to a maximum of $10, was removed from the old VI (new Title IX) "Excise Taxes" to this Title X (special Taxes).

[2] The estimates made by the conference committee are as follows:

Incomes	$851,000,000
Excess-Profits	1,000,000,000
Distilled Spirits	140,000,000
Fermented Liquors	46,000,000
Wines and Cordials	7,000,000
Soft Drinks and Syrups	13,000,000
Tobacco	63,400,000
Transportation	157,300,000
Telegraph, Telephone and Radio Messages	7,000,000
Insurance	5,000,000
Gross Sales	58,650,000
Admissions and Dues	51,500 000
Stamps	29,000,000
Estates	5,000,000
Virgin Islands Goods	20,000
First Class Mail	70,000,000
Second Class Mail	6,000,000
Total	$2,509,870,000

When the Secretary of the Treasury rendered his annual *Report* in Dec., 1917, he increased the estimates of the Excess-Property Tax to $1,226 millions and of the Estate Tax to 70 millions.

additional war revenue for 1918 was expected to be 2½ to 3½ billions. These figures, however, present no adequate picture of the actual tax burden imposed by the war. To do this, it would be necessary to add the proceeds of existing taxes, so far as they exceed the normal pre-war figures. We have seen that the internal revenue receipts for 1917 were over 800 millions. It seemed not at all unlikely that the revenue from the same sources for 1918 would be around a billion. If to this we add approximately the quarter of a billion derived from customs, we should have a probable tax revenue of about 3¾ billions.[1] Deducting the 600–650 millions which represent the average annual yield of the customs and internal revenue for the half dozen years before the outbreak of the European war, we should have as the additional war revenue for 1918 between 3 and 3¼ billions.

The next question is whether the war revenue act endeavors to raise too much or too little by taxation. We shall not attempt to discuss here the problem of loans *versus* taxes or to present the economic theory of public credit.[2] Suffice it to say that each method is unsatisfactory when pushed to an extreme. The chief disadvantage of loans is that, if they are not based on a solid foundation of taxes, they lead to a progressive deterioration of public credit and thus in part defeat their own objects; while the chief disadvantage of excessive taxation is the tendency to disrupt or to repress enterprise to such an extent that the industrial foundations of the war itself will be weakened. What has been generally overlooked, however, is the slight difference, measured in percentages, between an undue and a proper utilization of public credit.

The great conflicts of the nineteenth century have been conducted almost exclusively on the theory of loans. The figures ordinarily found are fallacious because they fail to distinguish between total and war expenditures on the one hand and total and war taxation on the other. If, as is the only proper method, we attempt to ascertain what proportion of strictly war expenses are defrayed out of war taxes and what proportion out of war loans, we shall find that the rôle played by war taxes is very much less than has usually been estimated. In the history of

[1] As a matter of fact the actual revenues for 1918 turned out to be $3,672,847,000. For details see Appendix, Table VII., *infra*, p. 714.

[2] *Cf.* chap. xxiii, *infra*, pp. 722 *et seq.*

the Civil War, for instance, it will be seen from the table [1] appended that, if we compare total taxes with loans, the proportion raised by taxes in the first full year of the war was under 9 per cent, and that it rose in the next year to only 12 per cent, and in the two succeeding years to only 16 per cent. If, however, war taxes are compared with war expenditures, as is proper, the showing is far worse. If we estimate the ordinary tax revenues and expenditures at about fifty millions (in 1860 they were each about fifty-three millions) it appears from the table [2] below that the proportion of war taxes to war expenditures was, in the first full year of the war, only one-fifth of 1 per cent and that even in the second year it reached only 8½ per cent. In other words, the first half of the war was conducted almost exclusively on the loan policy. The disastrous results are only too well known.

If we compare the fiscal program of Great Britain in the present war with that of the other belligerents, we shall find that the difference is much less than is commonly supposed. As a matter of fact,[3] the war taxes in the first year of the war (which represented six months of the fiscal year) amounted to a little over 7 per cent of the war expenditures. In the second year of the war the proportion rose to over 9 per cent

[1] Taxes and Loans in the Civil War (in Millions of Dollars)

	Customs	*Internal revenue*	*Direct tax*	*Total tax revenues*	*Loans*	*Total loans and taxes*	*Per cent obtained by taxes*
1862	49.1	.....	1.8	50.9	529.7	571.6	8.9
1863	69.1	37.6	1.5	108.2	775.2	883.4	12.2
1864	102.3	109.7	.5	212.5	1088.2	1300.7	16.3
1865	84.9	209.5	1.2	295.6	1474.5	1770.1	16.1

These figures differ from those of H. C. Adams, *Public Debts*, p. 132, which have been repeated by Bastable, *Public Finance*, p. 653, and since then by many others. The first three and the fifth columns of the above table are taken from the annual reports of the secretary of the treasury; the other columns are obtained by simple computation.

[2] Expenditure and Taxes in the Civil War (in Millions of Dollars)

	Total expenditures	*War expenditures*	*Total taxes*	*War taxes*	*Percentage of war taxes to war expenditures*
1862...	477.8	427.8	50.9	1.	.02
1863...	729.9	679.9	108.2	58.2	8.5
1864...	877.4	827.4	212.5	162.5	19.6
1865...	1309.	1259.1	295.6	145.6	11.5

[3] *Cf.* the detailed tables, *infra*, p. 760.

and in the third year to 17½ per cent. The real contrast with the United States during the Civil War resides in the fact that Great Britain was, during the first three years of war, just about one year ahead of the United States. That one year's difference, however, in the furnishing of an ample tax revenue quite sufficed to preserve Great Britain from the results of the American fiscal policy. The same is true when in the present war we compare Great Britain with the other belligerents, which, even in the case of France and Germany, have done no better than did the United States during the first two years of the Civil War. The significant fact for our purposes is that in the third year of war, after the imposition of heavy tax burdens, Great Britain was raising only a little over one-sixth of the war expenditures by war taxation, while the other belligerents have been doing still less. Although the proportion during the fourth year will probably be slightly higher,[1] the British government has steadfastly refused to make any substantial change in the policy which results in securing by far the greater part of war expenditures from war loans.

In the United States, where, at the time of writing, the first fiscal war year is only half completed, it is impossible to present more than rough calculations. If the Secretary of the Treasury should be correct in his estimate that the total expenditures will be about nineteen and a half billions,[2] the proportion of war taxes to war expenditures would be about one-sixth, a figure which compares favorably both with Great Britain and with our own Civil War experiences. It is, however, ludicrously less than the amount proposed by some of the enthusiasts both in Congress and in the academic world, who spoke about raising the entire outlay by taxation. It is also

[1] As a matter of fact, it was 18%. *Cf. infra*, p. 760.

[2] The exact estimates are nowhere to be found in the annual report of the secretary of the treasury for 1917. By combining various figures, however, we get the following result:

Ordinary expenditures (p. 56)	12,316,295,223
Postal expenditures (p. 73)	333,200,000
Loans to Allies (p. 17)	7,000,000,000
Total expenditures	19,649,495,223

By the time the year was over the expenditures turned out to be only about fourteen billions, far less than the secretary had estimated. This made the actual proportion of war expenditures derived from war taxes 24.8%. In the following year it was only 18.6%. See the table, *infra*, p. 767.

significant that the secretary of the treasury, who at the outset propounded the 50–50 per cent theory—that one-half of the war expenditures should be defrayed by war taxes—should have arrived in his annual report in December at the undesirability of levying any more taxes for the present.[1] This conclusion was evidently forced upon him by the financial depression which supervened in the last quarter of 1917 and which was popularly ascribed to the new tax law. As a matter of fact, the law was only partly responsible; and in so far as there was any responsibility at all, the cause is to be sought, as we shall see, in the defects of the law, rather than in the sum to be raised. We may conclude, therefore, that the new law does not err on the side of excessive taxation. But it is probable that about as much is sought to be raised by taxation as is prudent at the time.[2] Not only the amount, but the relative proportion, of taxation is a far heavier one than has ever been previously attempted in the first year of war.

We now come to the question of how this burden is distributed. The old-time classification of taxes into direct and indirect not only has lost its former usefulness but is without scientific foundation. In former times, when the mass of indirect taxes rested upon the poorer classes, the distinction corresponded roughly to the contrast between wealth and poverty, and the abolition of indirect taxes accordingly became a leading demand of social reformers. In modern times where the so-called indirect taxes have largely been removed from the necessaries of life, and imposed upon luxuries or articles of harmful consumption, the contrast has lost its point. Indirect taxes are no longer necessarily taxes upon the poor. But in the second place, the criterion of distinction has been abandoned by modern science. In direct taxes, the taxpayer is supposed to be the taxbearer; in indirect taxes, one man pays the tax and another is supposed ultimately to bear the burden. Even a superficial acquaintance, however, with the newer theories of incidence of taxation discloses the fact that many so-called direct taxes are shifted and many so-called indirect

[1] "It is my earnest conviction that the general economy of the war should be permitted to readjust itself to the new revenue laws before consideration should be given to the imposition of additional tax burdens." *Report*, p. 4.

[2] The new law of 1919 increased the war tax revenue from $3,253 to $3,874 millions, in the face of an increase of war expenditures from 13 to almost 18 billions. *Cf.* the table, *infra*, p. 714.

taxes may be borne by the person who originally pays the tax. Even to relegate the distinction to the mind of the legislator, as was suggested by John Stuart Mill, helps little. In the present law, for instance, no one knows whether it was the intention of the legislator that the insurance taxes or the so-called excise taxes should be paid by the producer or by the consumer. In the automobile tax both views were represented in Congress. But even assuming, what is not improbable, that most of the excise taxes are intended to rest on the consumer, what shall we say of the motorboat tax, which, as the law distinctly declares, shall be paid by the user? Is the automobile tax, then, indirect and the motorboat tax direct? And even if we declare all of the excise taxes indirect, most of them are imposed on luxuries, and thus fail to disclose the chief characteristic which has hitherto been associated with indirect taxes. The distinction, therefore, is both unclear and useless.

A classification more suited to modern conditions is that into taxes on wealth, business, exchange (in the widest sense of the term, including transportation and communication of intelligence and power), and consumption, which last category might be subdivided into taxes on luxuries or harmful consumption and on ordinary expenditure. This fourfold classification might be further compressed into the distinction between taxes on wealth and luxury on the one hand and on the mass of consumption on the other. Business taxes would then be included in the first division and taxes on exchange in the second, while taxes on expenditure would fall into either the first or the second, according to their nature. The advantage of this classification is that it is apt to throw light on the problem of chief interest to modern democracy—the equitable distribution of tax burdens between the rich and the poor.

How do the various taxes proposed by the new revenue law fit into this fourtold classification? Since wealth is to be measured in terms of either a fund or a flow, it is obvious that in the first class are to be included taxes on property as well as on income. The present law imposes, it is true, only an income tax; but it is not at all unlikely that we may again have a tax on land or other property. The estate tax would also fall within the same group, irrespective of the question whether we regard it as a tax on capital or on the income of the recipient. In the second category, taxes on business, there ought to be included, as we shall see later, not only the excess-profits but

the corporate-income tax. In the third group, taxes on exchange, would be comprised the so-called war taxes on facilities furnished by public utilities, and the stamp taxes. To the first division of the fourth group, taxes on injurious or harmful consumption, should be assigned the taxes on beverages, admissions and dues, leaving for the second subdivision customs duties and the insurance tax. This disposes of everything except the so-called excise taxes, which will probably best fit into the subdivision of taxes on luxurious consumption. But even if they should be classified under business taxes, it would make little difference, because in either case they would fall within the first of two main divisions, taxes on wealth and luxury as against taxes on general consumption.

According to this classification, the new taxes on wealth amount to about 74 per cent of the whole, the taxes on luxurious or harmful consumption to about 13 per cent, and the taxes on exchange and general expenditure to a little less than 13 per cent.[1] This record is almost as good as that of Great Britain, where an even larger proportion of the new war taxes has been derived from wealth or luxurious or harmful consumption. It is significant evidence of the progress that has been made in the conceptions of fiscal justice as a result of the democratic development of the last generation. The contrast of this distribution with that of the Civil War period could not be more striking.

Since, therefore, the overwhelming proportion of the new revenue was to come from taxes on income and excess profits,

[1] DISTRIBUTION OF WAR TAXES (IN MILLIONS OF DOLLARS)

		Wealth	
Income	$851	= $1,856, or 73 per cent	
Excess Profits	1,000		
Estate	5		
		Luxuries and Harmful Consumption	
Liquors	$269.4	= $328.1, or 13 per cent	
Excises	58.7		
		Exchange	
Transportation	$157.3	= $269.	=$325.1, or 12.6 per cent
Telegraph, etc.	7.		
Stamp	29.		
Postage	76.		
		Expenditure	
Admissions	$51.1	= $56.1	
Insurance	76.		

any adequate interpretation of the law must deal primarily with these sources.

IV. *The Income Tax*

The American income tax has gone through a rapid development. Imposed originally as an emergency measure during the Civil War, it disappeared in 1872. Re-enacted in 1894, it was declared unconstitutional. A prolonged discussion led to the adoption of the sixteenth Amendment in 1911 and to the passage of the law in 1913.[1] As was inevitable in a pioneer measure the act was not without defects in both theory and administrative provisions. Some of these were considered by a committee of the National Tax Association of which the present writer was chairman and shortly thereafter not a few of the suggested amendments were adopted.

The chief purpose of the Act of September 8, 1916, referred to above, was to secure increased revenue. Accordingly, the rate of the normal tax was increased to 2 per cent and that of the additional tax to a scale of from 1 to 13 per cent. Other important changes in the law were as follows: (1) the tax was definitely imposed upon non-resident aliens; (2) deductions were permitted for taxes levied by foreign countries; (3) allowance was made for losses actually sustained in transactions not connected with one's regular business, provided they did not exceed the profits therefrom; (4) in the case of oil and gas wells and mines a reasonable allowance was permitted for actual reduction in output or for depletion; (5) partners were allowed to deduct a proportionate share of the partnership income which would be exempted if taxed to individuals; (6) provisions was made for the publication of full and adequate statistics. Among the minor changes were those requiring all individuals to make a return of dividends received, permitting the taxpayer to keep his books according to the method of accruals in lieu of that of actual receipts, and allowing the commissioner of internal revenue to grant an extension of time in making returns.

While the law of 1916 resulted in a revenue of about 360 millions, the law of 1917 was designed to increase the yield to about a billion and a quarter dollars. The chief content of the

[1] For an appreciation of this law by the present writer, see Seligman, *The Income Tax*, 2d edition, 1914, last chapter.

law, therefore, consists in changes of rates. Advantage was also taken of the opportunity to make alterations in other provisions.

The change in rates was of a threefold character: an increase of the normal tax, a lowering of the exemption, and a rise in the scale of progression. A supplementary normal tax of 2 per cent was imposed, bringing the total to 4 per cent. The law furthermore provides for a reform that had been widely urged by those who considered the exemption of $3,000–4,000 entirely too high. Accordingly, in the case of the supplementary normal tax the exemption was reduced to $1,000 for unmarried and $2,000 for married persons. The law also provides for an additional exemption of $200 for each child under eighteen years of age or incapable of self-support because of mental or physical defect.

In order to counterbalance this reduction, which will bring into the toils of the law millions of new taxpayers, the rates on the higher incomes were sharply increased. The original law, it will be remembered, had provided for a so-called additional tax (popularly called the surtax or, sometimes, the supertax) on all incomes over $20,000, ranging from 1 to 8 per cent on the highest amounts. The law of 1916, as we have noted, increased the graduated scale so as to run from 1 to 13 per cent. The law of 1917 reduced to $5,000 the amount at which graduation begins and provided an entirely different scale, ranging from 1 to 50 per cent, for the supplementary additional tax. The result is that the maximum rate was now 67 per cent, that is, 2 per cent old normal tax, 2 per cent supplementary normal tax, 13 per cent old additional tax and 50 per cent new additional tax.[1]

This is the highwater mark thus far reached in the history of taxation. Never before, in the annals of civilization, has an attempt been made to take as much as two-thirds of a man's income by taxation. The nearest approach was during the great political struggles in mediæval Italy, where, as in Florence, the income tax once reached a figure of 50 per cent.[2] In com-

[1] The 1918 act went still further in making the maximum 77% on portions of income over a million dollars. This was accomplished by making the normal rate 12% (reduced to 6% in the first $4,000 of taxable income) and the surtax 65%. For 1919 the normal rates were reduced to 8% and 4% respectively, making the maximum rate 73%. *Cf.* the Appendix, *infra*, p. 713.

[2] *Cf.* Seligman, *Progressive Taxation in Theory and Practice*, 2d edition, 1908, p. 22.

paring our present income tax with the British, moreover, it is to be noted that our rates are much higher on the larger incomes and much smaller on the lower and moderate incomes. The American scale is an eloquent testimony to the fact not only that large fortunes are far more numerous here than abroad, but also that there is greater appreciation of the democratic principles of fiscal justice. For the overwhelming trend of modern opinion is clearly in the direction of applying to excessive fortunes the principle of faculty or ability to pay. It still remains to be seen, however, whether the new law, with its exceedingly high rates, will turn out to be as workable administratively and as productive fiscally as a somewhat lower scale would have been.[1]

The second change in the law is the virtual abandonment of the stoppage-at-source method of collection. It will be remembered that the two leading types of income tax that had developed during the last generation were the so-called lump-sum method of Prussia and the schedule method of Great Britain. The Prussian system, which rested finally upon accurate official assessment, depended for its success upon an incorruptible civil service and the fear instilled into the average taxpayer of making false returns. Great Britain had long since abandoned the scheme and had substituted the plan of imposing the responsibility of the tax upon the person who paid the income rather than upon the recipient. As between the unchecked lump-sum and the stoppage-at-source method it is clear that under American conditions the latter was preferable. At the close, however, of the discussion in 1913, an alternative plan was suggested, to which the present writer gave the name of information-at-source, designed to achieve the substantial purposes of the collection-at-source method without its discomforts and complications. This alteration, which almost succeeded in 1913, and again in 1916, and which was warmly espoused by the income-tax committee of the National Tax Association, has now been finally adopted in essence. The law made the tax collectible from the recipient of the income, but imposed upon the payers of income the obligation to give full information of the amount and conditions of payment. Information is required from corporations as to dividend payments; from

[1] This doubt has been confirmed in the great falling off of the revenues in the upper schedules in 1919 and 1920, and the nation-wide movement for a reduction of the excessive surtaxes.

brokers as to details of transactions; and, in general, from all persons making payment to any other person of any "fixed or determinable gains, profits and income over $800." Only two exceptions permitted. Withholding at the source is retained for the original normal tax in the case of income accruing to non-resident aliens and of interest on tax-free bonds. The latter exception was inserted as a concession to bondholders who, relying upon the promise of the corporations to assume the tax, had paid so much more for the bonds. It is to be regretted, however, that the law fails to include the provision, found in the British statute, which prohibits for the future the inclusion of such tax-free covenants in corporate bonds.

The substitution of information-at-source marks an advance in the law, although it still remains to be seen whether the new system will prove more effective or less cumbrous than the old. In any event, however, the chief objection to the uncontrolled lump-sum method, employed in our earlier income-tax laws, has been removed.

On the fundamental question of what constitutes income the new law does not take any fresh stand. This still remains a difficulty which, however, not only is shared by many other income-tax laws but is traceable to an inadequate analysis. The distinction betwen capital and income has received far less scientific attention than it deserves. It may be said that there are at least three different conceptions of income found in economic literature: the one emphasizes the idea of regularity or recurrence; the second accentuates the idea of product or return from an enduring source; the third, or net-profit theory, lays stress on the surplus of what comes in over what goes out. It is impossible here to discuss the widely divergent practical consequences of these theories. It may be said, however, that until economists have decided which of the three is correct, the interpretation of the law is bound to create endless trouble. Some of the chief difficulties of the interpretation are still associated with the question of stock dividends and depreciation in the market value of securities.[1]

[1] For a subsequent discussion of the concept of income see an article by the present writer on "Are Stock Dividends Income" in *The American Economic Review*, vol. ix. (1919) pp. 517–536; the article by R. M. Haig in *The Federal Income Tax. Columbia University Lectures*, 1921, pp. 1–18; and F. R. Fairchild, "Federal Taxation of Income and Profits" in *Taxes and Proceedings of the 33d Annual Meeting of the American 5th Economic Association in Atlantic City, 1920*, 1921, pp. 149 *et seq.*

An important change in the deductions permitted in the computation of taxable income is found in the treatment accorded to gifts for religious, charitable, scientific or educational purposes. When the bill was in committee, fear was expressed lest the high rates should check the flow of philanthropic gifts. In order partly at least to obviate a consequence which would be deplorable in a country where charity is overwhelmingly of a private character, it is provided that all such gifts may be deducted, provided they do not exceed fifteen per cent of the taxable income. This interesting departure is in line with the American policy of tax exemption for educational and philanthropic institutions. It is to be regretted, however, that in the estate tax a similar provision has been omitted.[1]

Two other important changes were made in the list of deductions. In the original act a deduction was permitted for interest on debts. It was pointed out during the discussion that, inasmuch as the first issue of Liberty Bonds was tax exempt, it would be profitable for individuals to finance their bond purchases by borrowing, for they would save the tax not only on the bond interest received but on the loan interest paid. It was to obviate this invitation to inflation and fiscal injustice that the law excepted from the permissible deduction interest on debt incurred for the purchase of tax-free government bonds.

The other point has reference to the deduction for taxes. It is plain that if all taxes continue to be deducted, the payment of a large income tax in any one year will operate as a substantial and progressive reduction of the tax in following years. It is therefore provided that the permission to deduct taxes shall not apply to income and excess-profits taxes. In any one year, however, the net income may be credited with the excess-profits tax assessed in the same year.

Finally, the exemption heretofore accorded to the interest on government bonds is limited to the particular exemptions allowed in the acts authorizing the bond issues. The new four per cent bonds carry with them, as is well known, an exemption from the normal income tax only.

Up to this point we have discussed the individual income tax. The law, however, provides, as before, also for a corporate income tax. In addition to the existing normal tax of two per cent, a supplementary tax of four per cent is imposed upon the income of every corporation, joint stock company or association,

[1] This oversight was corrected in the act of 1918.

or insurance company, but not including partnerships. The result is that corporations will hereafter pay a tax of six per cent on their income.[1] In computing the tax, however, all dividends received by one corporation from another taxable corporation are deductible—an important concession to holding companies but a concession limited to the supplementary tax.[2] The limitations on the deduction for interest and taxes referred to above in the case of individuals are applicable also to corporations, as is the provision permitting the crediting to income of the excess-profits tax levied in the same year.

Corporations, however, are subject to a further tax of ten per cent on the amount of profits remaining undistributed six months after the end of the year. Income actually invested in business or in federal bonds is exempted from this additional tax; but if it transpires that profits retained for employment in the business are not so employed or are not reasonably required therein, they shall be subject to a tax of fifteen per cent. It may be conjectured that these provisions, if enforced, will lead to a speedy distribution of all corporate profits that should properly go to the stockholders, and perhaps of some that ought properly to be reinvested in the business.[3]

Finally, attention may be called to a provision permitting the payment of the income tax, both corporate and individual, in instalments of twenty-five per cent at intervals of one, two and four months after the close of the taxable year, the final instalment to be payable by June 15, as before.

In any fair estimate of the present law five defects may be noted, some of them survivals, some of them additions.

The first weakness is the failure to introduce differentiation between earned and unearnd income. An attempt was made to persuade Congress to adopt this distinction, which, as is well known, was initiated in Great Britain almost a decade ago. The reason advanced for the refusal—the fear of further complicating the tax—is far from convincing. Simplicity gained at the expense of equity is not to be admired. The situation is in fact aggravated by the extension of the excess-profits tax to professional incomes, as a result of which, earned incomes, in-

[1] The law of 1918 increased the rate of the corporation tax to 12% for 1918, and 10% thereafter. An initial exemption of $2,000 was allowed.

[2] The law of 1918 abolished this limitation, as well as that on the amount of deductible interest.

[3] The undistributed property tax was dropped in the law of 1918.

stead of being taxed less, will actually be taxed more than unearned incomes. This is of course a travesty of justice.

The second defect is that returns, instead of being demanded from every one, are required only from the non-exempt classes, that is, from those whose income exceeds $1,000–2,000 or $3,000–4000 respectively.[1] This, coupled with the failure to compel a return of income from government tax-free bonds, will prevent the collection of valuable information as to the total social income and its distribution. A return, including the entire income, should be required, as is almost uniformly the case elsewhere, from every citizen.

Third, the provision as to the calculation of losses and gains is still inequitable. On any one of the three different theories of income referred to above, our present practice of counting certain gains as income and of refusing to allow for corresponding losses is not only indefensible, but sure to create gross inequalities.[2]

In the fourth place, the treatment accorded to dividends is highly questionable. Dividends must, indeed, be reported by individuals and, although not subject to the ordinary normal tax, are liable to both the supplementary normal tax and the additional taxes. A new section, however, provides that dividends are taxable at the rates prescribed for the years in which the corporate profits are accumulated. This is unjust because the dividends ought to be considered income when received, irrespective of when the profits were earned. If the war should last several years and be attended by an increase of war taxes, it is likely that many wealthy stockholders will escape by the fact of the corporate profits having been originally earned in the period before the high taxes were imposed. Moreover, the law will probably be so complicated as not to be easy of enforcement. For the rate of the tax will depend upon the amount of total income in any one year and the identical amount of dividend may form an entirely different proportion of that income from year to year. It will be increasingly difficult, therefore, to administer the provision. In the meantime, great confusion will ensue.[3]

[1] The number of returns filed in 1918 was 4,425,114 as compared with 78,000 in 1917. *Cf. Statistics of Income Compiled from the Returns of 1918.* 1021, p. 5.

[2] This defect was partly removed by the law of 1918 which permits the deduction of all losses whether incurred in trade or otherwise.

[3] The law of 1918 made dividends taxable at the rate in force in the year when declared.

The final defect is that no machinery has yet been devised to check the returns from individuals engaged in business or occupations. In the case of large corporations and partnerships, as well as individual incomes from securities, the system of information-at-source, together with the observance of modern accounting rules, will in all probability ensure fair accuracy in the returns. But where neither of these safeguards is applicable, a large loophole is left open. Where the rates of taxation are as high as at present, the dangers of evasion are multiplied; and evasion means not only loss of revenue, but inequality. Much has been done elsewhere to institute checks designed to diminish this danger. While some of the statements [1] advanced in and out of Congress as to the widespread evasions in the present law are clearly exaggerated, there is still room for decided improvement in administration.

V. *The Excess-Profits Tax*

Although the income tax, both old and new, is designed to provide about the same revenue as the excess-profits tax [2] the latter is the novel part of the law. What is its significance?

The first point to be emphasized is that it is a business tax. The criteria that may be employed in classifying taxes are manifold. For the purpose, however, of explaining this new impost it will suffice to observe that taxes on wealth are susceptible of a threefold division. The tax may be on either property or income; on either individuals or corporations; on either persons or things. It is this last distinction which is of consequence here—the distinction which the lawyers make between taxes *in personam* and *in rem*. Among the "things" on which taxes may be imposed are land, capital and business. The excess-profits tax is one on the business, irrespective of the person who conducts it. It is like the real-estate tax in New York, assessed on the land, without regard to the owner. The objection, therefore, is not valid that because the tax is imposed on profits, it constitutes double taxation, in superim-

[1] *Cf. The United States Income Tax Steal? The Facts and the Proofs about $320,000,000 taken Annually by the Rich from the U. S. Treasury.* By Basil M. Manley.

[2] Income tax 1,201 millions; excess profits tax 1,226 millions. See *Report of the Secretary of Treasury for 1917*, p. 71.

As a matter of fact the income tax yielded 1,094 and the excess-profits tax 1,844 millions in 1917.

posing one income tax upon another. This is the same confusion of thought which has led some writers to object to the inclusion of a corporate-income tax in a law which endeavors to reach the entire income of the individual. The corporate-income tax, like the excess-profits tax, is a tax on the business, not a tax on the individual; a tax on a thing, not on a person.

In the second place, the excess-profits tax is not a war-profits tax, if by this term we mean a tax imposed upon the additional profits resulting from the war. This constitutes its chief difference from the war-profits taxes levied elsewhere.

The almost simultaneous institution of the war-profits taxes abroad is easy of comprehension. Never before in the history of the world have such gigantic sums been expended by belligerents or have such colossal gains been made by private individuals in belligerent and neutral countries alike. It was a natural feeling that no private enterprise should be permitted to make inordinate gains out of the misery of humanity, and that the community is entitled to a great part of the profits for which no individual enterprise is really responsible. The consequence was that the government everywhere put in a claim to a large share of these profits due to the war. The proportion has risen in some countries to eighty or ninety per cent, and the war profits have in general been defined as the excess of profits during the war over those during a pre-war period.

The reason which induced Congress to modify this principle was that not a few of our largest business enterprises had been making immense profits in the pre-war period, and that, inasmuch as the profits, both past and present, were scarcely being touched by the corporate-income tax, these enterprises would virtually be exempt, while their more unfortunate competitors, who had done relatively poorly during the pre-war period, would now be heavily burdened. The decision was therefore reached to levy the tax not on war profits as such, but on excess profits in general. Although the tax is called the "war excess profits tax," the term really means the tax on excess profits levied during the war, just as the terms "war excise taxes" or "war income tax" mean the respective taxes levied during the war.

The significant fact, however, is that nothing is said about the limitation of the tax to the period of the war. In the war-profits taxes abroad the taxes cease automatically with the end of the war, for where there is no war there can be no war

profits. It is entirely possible, however, for our tax to continue after the war, just as it is possible that fiscal exigencies may compel the continuance, in whole or in part, of our war income tax or of our war excises. It will be seen, therefore, that we have here, ready to hand, a potential source of the future income which will be so sorely needed hereafter, and for which European statesmen and publicists have been dimly groping.

It has been thought by some that the principle is something new in taxation. Professor T. S. Adams, for instance, emphasizes the fact [1] that it is a reversion to the benefit theory of taxation and is to be considered as an extension of the special-assessment doctrine.

Both of these statements, however, involve a partial misconception. The essence of a special assessment consists of a measurable benefit accruing to an individual as a member of a definite area, from a particular service rendered, and calling for an outlay, by the government. In a tax there is never such a particular service nor a separately measurable benefit. The criterion is not benefit but faculty or ability to pay. The confusion arises from the failure to observe, as was pointed out many years ago,[2] that ability connotes not only the old-time consumption or sacrifice element but also the production or privilege element. A business tax is none the less based upon ability to pay because the predominant criterion may consist in the profits derived in part from the privileges due to the general economic or legal environment. The excess-profits tax is a tax in which, as in many others, the ability of the taxpayer is measured, in part at least, by the privileges enjoyed. It is not to be confounded with a special assessment. There is no special measurable benefit conferred by a particular service rendered, and involving an outlay, by the government.[3]

[1] "Principles of Excess-Profits Taxation," in the *Annals of the American Academy of Political and Social Science*, volume lxxv., p. 154; and more fully in "Federal Taxes upon Income and Excess Profits," in the *American Economic Review*, vol. viii., no. 1, supplement, March, 1918, Papers and Proceedings of the 30th Annual Meeting of the American Economic Association. In a later paper "Should the Excess-Profits Tax be repealed" in *The Quarterly Journal of Economics*, xxxv. (1921), p. 363, Professor Adams modifies his conception.

[2] Seligman, *Progressive Taxation in Theory and Practice*, 1894, p. 191; *cf.* 2d edition, 1918, pp. 291–292. *Cf.* the various passages in the present volume, pp. 340, 418, 438–444.

[3] For a fuller statement of this point *cf.* the *American Economic Review*, vol. viii., no. 1, supplement, where Professor Adams' paper is considered.

When, however, we come to consider the precise way in which this new business tax has been worked out, we find that it is open to serious criticism. In the European laws the taxes are not on war excess profits but on excess war profits, that is, on the excess of war profits over peace profits.[1] Since, however, our plan is to tax excessive profits in general rather than the excess over a pre-war standard, the criterion had to be lodged elsewhere than in pre-war profits. This criterion of normal profits is declared to be a certain percentage of the capital employed, the pre-war period being utilized only incidentally in ascertaining this normal percentage. That is to say, in computing excess profits, the law takes the excess over a so-called deduction or normal amount, consisting of a fixed sum ($3,000 for domestic corporations, or $6,000 for partnerships, citizens or residents), together with an amount equal to the percentage of the invested capital represented by the average annual income during the pre-war period, provided that this percentage shall in no case be less than 7 nor more than 9 per cent of the capital. The pre-war period is held to be the period from 1911 to 1914. In case the business was not in existence in those years, the deduction is fixed at 8 per cent instead of the 7–9 per cent. And in case there was no income or a very low income during the pre-war period, the criterion is the percentage of capital earned by a similar or representative business.

From this base line of normal profits are computed the excess profits, the tax rising progressively with the excess, being fixed at 20 per cent on the excess profits up to 15 per cent; 35 per cent on the excess from 15 to 20 per cent; 35 per cent on the excess from 20 to 25 per cent; 45 per cent on the excess from 25 to 33 per cent; and 60 per cent on the excess profits over 33 per cent.[2]

[1] The British War-Profits Duty permitted as an alternative, when more favorable to the taxpayer, the so-called "percentage standard" based on invested capital. Even though far more successfully administered than the American tax, it was abolished in 1921 as soon as possible after the war. For a thorough study of its working *cf.* R. M. Haig, *The Taxation of Excess Profits in Great Britain, American Economic Review*, vol. x., *Supplement*, Dec., 1920. The rates were as follows: 1915, 50%; 1916, 60%; 1917, 80% 1919, 40%; 1920, 60%.

[2] The law of 1918 changed the name to the War-Profits and Excess-Profits Tax because it now also granted a "war-profits credit" consisting of $3,000 and an amount equal to the average net income for the pre-war period (1911–1913) plus or minus 10% of the difference between the invested

It is obvious that the important point here lies in the computation of capital, for with one exception [1] income is defined precisely alike in the excess-profits and the income-tax laws. The greater the amount of the "invested capital" as compared with a given income, the smaller will be the percentage and the tax. What constitutes invested capital, however, is so elusive as to be virtually impossible of precise computation. Not only will there be gross inequality between businesses which enjoy the same income but which are variously capitalized, thus putting extra taxation on small and conservatively capitalized concerns; but all manner of opportunity will be afforded for evasion of the law. The effort made to define capital in the law is unavailing. Invested capital is defined as actual cash paid in, the actual cash value of tangible property, and the paid-in or earned surplus employed in the business. Patents and copyrights are included up to the par value of the stock paid therefor and the same rule is declared applicable to the goodwill, trade-marks, and franchises or other intangible property, provided that if purchased before 1917 the amount is limited to 20 per cent of the capital. The inadequacy of these provisions is manifest.

It has been contended, in defense of the law, that it is on the whole immaterial whether the criterion be sought in income or in capital; for capital, we are told, is nothing but capitalized income.[2] In reality, however, capital is not capitalized income;

capital for the pre-war period and for the taxable year. The "excess profits credit" was fixed at $3,000 plus 8% of the invested capital. The rates were (1) 3% on the excess of the net income over the excess-profits credit to 20% of the capital, (2) 65% on the income over 20% of the capital; and (3) the sum, if any, by which 30% of the income in excess of the war-profits credit exceeded the taxes in (1) and (2). For 1919 and thereafter the rates in (1) and (2) were reduced to 20% and 40% respectively and the third bracket was dropped.

[1] The deductions allowed from corporate gross income in the excess-profits tax followed the corporation excise tax law of 1909 and not the income-tax law. The difference, it will be remembered, is that in the former law deduction is permitted on bonded indebtedness to an amount not exceeding the capital; whereas in the latter, the deduction was until 1918 limited to one-half the sum of the bonds and stock.

[2] This point is made by Professor Adams in the address cited *supra*, p. 702, "Federal Taxes upon Income and Excess Profits." This marks a decided change of mind from his earlier statement in *Financial Mobilization for War, Papers published by the Western Economic Society and the City Club of Chicago*, 1917, p. 117: "To that question in this country filled with corporations whose capital accounts mean nothing, there is only one

capital is the capitalization not only of present income but of anticipated future income, which is a very different thing. If, as frequently happens, the anticipated future income does not materialize, there is a vital difference between a tax on capital and a tax on income. The objection to the law still remains, as before, that the choice of capital not only constitutes a clumsy attempt to reach taxable ability, but introduces a gross inequality in principle and a deplorable uncertainty in administration. While something may no doubt be done to clear up the ambiguities and to remove some crass inequities, enough will remain to deprive the measure of a claim to scientific or practical validity.

The most serious objection to the law, however, has yet to be mentioned. Even assuming that the above difficulties were removed, that the capital could be accurately estimated, and that it varied in amount proportionally with the income—even on these unlikely assumptions, the tax would still be defective. This is due to the criterion chosen for the basis of the graduated scale. Something can be said for a graduated tax on income; something can even be said for a graduated tax on capital; but it is difficult to say anything in defense of a tax which is graduated on the varying percentage which income bears to capital. To penalize enterprise and ingenuity in a way that is not accomplished by a tax on either capital or income—this is the unique distinction of the law. For, in the first place, while it is true that excess profits are sometimes the result, in part at least, of the social environment, they are not infrequently to be ascribed to individual ability and inventiveness. While it is entirely proper that a share of the profits should go to the community, it is not at all clear that the tax should be graduated according to the degree of inventiveness displayed. But there is a still more important consideration. Almost all large businesses have grown from humble begin-

answer—avoid the capital basis, whenever by human ingenuity it is possible to do so." Official experience had convinced him that the excess profits or capital basis was about as good as the war-profits basis, and he now secured the adoption of the dual or alternative method for the year 1918. Later he concluded that neither method was sufficiently accurate to serve as the basis of a permanent excess-profits tax, and he now stated that "the fundamental error is the attempt to perpetuate original investment or cost value. The essential point is that the original invested capital is a fictitious and unreal concept." *Quarterly Journal of Economics*, xxxv (1921), pp. 378, 379.

nings, and it is precisely in these humble beginnings that the percentage of the profits to the capital invested is apt to be the greatest. The criterion selected, therefore, is the one best calculated to repress industry, to check enterprise in its very inception, and to confer artificial advantages on large and well-established concerns. Nothing could be devised which would more effectively run counter to the long-established policy of the American government toward the maintenance of competition.[1]

VI. *Conclusion*

In summing up the above discussion we see that the new law is to be credited with three noteworthy achievements. In the first place, it will yield the most colossal revenue that has ever been attempted by a single enactment. To add, at one stroke, over two and one-half billions to the public income is an unprecedented accomplishment. It is true that war taxation covers only a small part of the war expenditure; but it must not be forgotten that this is far more than has been done by any of the belligerents except Great Britain and that it is considerably more than even Great Britain attempted during the early years of war. It is entirely probable, as it is highly desirable, that increased taxation should be imposed during the successive years of the war. A good beginning, however, has been made and it is fortunate that our legislators did not at this time succumb to the specious arguments of those who urged

[1] Almost two years after the above passage was published the defects of the tax were summed up by Secretary Glass in his *Finance Report* for 1919, p. 23, as follows: "It encourages wasteful expenditure, puts a premium on over-capitalization and a penalty on brains, energy and enterprise, discourages new ventures and confirms old ventures in their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices, and has been, and will, so long as it is maintained upon the statute books, continue to be, a material factor in the increased cost of living." The validity of the last sentence may be questioned, for taxes on net profits of competitive industries can normally not be shifted. The only exception is that in a state of rapidly rising prices there may for a time be no marginal or no-profits producer, so that a tax on profits may not be entirely a tax on surplus and thus non-shiftable. But whether even this condition prevailed throughout the war is open to doubt. *Cf.* David Friday, *Profits, Wages and Prices*, 1920, ch. xii.; R. M. Haig, *The Taxation of Excess Profits in Great Britain*, 1920, p. 155; and for the general theory, Seligman, *The Shifting and Incidence of Taxation*, 4th ed., 1921, p. 362.

that sustantially all, or even half, of the huge war expenditures should be defrayed out of taxes during the first year of war.

Second, the law is noteworthy for an adoption of democratic principles hitherto unrealized in fiscal history. To impose the great burden of taxation on wealth and luxurious consumption rather than on the expenditure of the mass of the people is to take an appreciable forward step in the direction of realizing the principle of ability to pay. The consequence of this stride in advance will doubtless be a lasting one, and we may well look forward to a perpetuation of the same principle after the war.

In the third place, the law is to be credited with the adoption of an ingenious expedient in the shape of the excess-profits tax. This, as we have pointed out, is not an excess war-profits tax, but a war excess-profits tax. That is, although imposed as a result of the war, it is a business tax on high profits in general. This constitutes at once its distinction from the superficially similar taxes abroad and its claim to recognition as a possibly permanent feature of our tax system. It is susceptible of vast increase during the war and in a modified form of a continued applicability after the war. It is not at all impossible that it may some day develop into a permanently important constituent of our revenue system.

As against these undoubted accomplishments are to be set three weaknesses. The first is the failure adequately to utilize other fiscal possibilities such as larger and additional stamp taxes notably on checks and small receipts, as well as taxes on quasi-luxuries. For the latter would at the same time serve to promote the desirable policy of restoring the favorable balance between social production and social consumption, so sorely needed in the war.

The second weakness is the failure to introduce the long awaited reforms in the administrative provisions of the income tax. Not a little, it is true, has been accomplished; but the enormous scale on which the tax is now levied accentuates the defects of those still existing omissions and commissions which were relatively innocuous under the preceding lower scale.

The third and most important drawback is the unfortunate principle adopted in the elaboration of the excess-profits tax. It is a principle which will return to plague the inventors. The law will in all probability be found to be almost unworkable, and even if this should not be the case, its technical

success will be purchased at the cost of gross inequality and of unfavorable effects on the true elements of economic prosperity.

Balancing the strong against the weak points of the law we may conclude that while the former represent lasting advantages the latter are susceptible of amelioration by comparatively simple changes. Taking it all in all, therefore, the war revenue act is to be welcomed as a notable achievement which will long be remembered in the annals of democratic progress.

TABLE I

TAXES ON SPIRITS, BEVERAGES AND TOBACCO

		Old rate	*Act of 1914*	*Act of 1916*	*Act of 1917*	*Act of 1918*
Distilled spirits						
For beverages	per gal.	$1.10	$1.10	$1.10	$3.20	$6.40
For non-beverages	per gal.				2.20	2.20
Imitation sparkling wine	per pint	.10	.10	...	...	...
Rectified (supplementary)	per gal.	...	...	...	.15	.30
Grape brandy	per gal.	.03	.55	.10	.20–.30	.60
Still wines						
14 per cent or less alcohol	per gal.	...	.08	.04	.08	.16
14–21 per cent alcohol	per gal.	...		.10	.20	.40
21–24 per cent alcohol	per gal.	...		.25	.50	1.00
Over 24 per cent alcohol	per gal.	...		1.10	3.20	6.40
Sparkling wines	per ½ pint	...	.03	.03	.06	.12
Artificially carbonated waters	per ½ pint	...	.015	.015	.03	.06
Liquors, cordials etc.	per ½ pint	...	.015	.015	.03	.06
Sirups and extracts		...	...	...	.05–.20	...
Soft drinks and mineral waters	per gal.	...	...	...	.01	...
Cereal beverages, less than ½% alcohol	on producer's price	...	...	...	...	15%
Grape juice, ginger ale, carbonated waters, etc.	on producer's price	...	...	...	...	10%
Natural mineral waters, etc.	per gal.	...	...	...	...	.02
Soft drinks, ice cream, etc.	for each 10c retail price	...	...	...	...	.01
Carbonic acid gas	per pound	...	...	...	.05	...
Fermented liquors	per barrel	1.00	1.50	1.50	3.00	6.00
Tobacco and snuff	per pound	.08	.08	.08	.13	.18
Cigars						
Weighing more than 3 pounds per 1000	per 1000	3.00	3.00	3.00	...	...
To retail for less than 4 cents each	per 1000	...	...	...	3.00	...
To retail for not more than 5 cents	per 1000	...	...	...	...	4.00
To retail for 4–7 cents	per 1000	...	...	...	4.00	
To retail for 6–8 cents	per 1000	...	...	...	...	6.00
To retail for 8–15 cents	per 1000	...	...	...	6.00	9.00
To retail for 15–20 cents	per 1000	...	...	...	8.00	12.00
To retail for over 20 cents	per 1000	...	...	...	10.00	15.00
Weighing not more than 3 pounds per 1000	per 1000	.75	.75	.75	1.00	1.50
Cigarettes						
Weighing more than 3 pounds per thousand	per 1000	1.25	1.15	1.25	2.05	3.00
Weighing not more than 3 pounds per 1000	per 1000	3.60	3.60	3.60	4.80	7.20
Cigarette paper	per 100	...	...	...	.01	...
Cigarette tubes	per 100	...	...	...	.02	.02

TABLE II

EXCISES AND MISCELLANEOUS TAXES [1]

		Old rate	*Act of 1917*	*Act of 1918*	*Rate in force in 1921*
Colored oleomargarine	per pound	10 cents	...	...	10 cents
Non-colored oleomargarine	per pound	1/4 cent	...	...	1/4 cent
Adulterated butter	per pound	10 cents	...	...	10 cents
Process butter	per pound	1/4 cent	...	...	3/4 cent
Filled cheese	per pound	1 cent	...	...	1 cent
Mixed flour	per barrel	4 cents	...	...	4 cents
Opium	per pound	$300	...	...	$300
Phosphorus matches	per 100	2 cents	...	...	2 cents
Bank circulation	per month	1/2 of 1 %	...	...	1/2 of 1 per cent
State bank notes	...	10 %	...	...	10%
Automobile trucks	...	...	3%	3%	3%
Automobiles and motorcycles	...	...	3%	5%	5%
Tires, parts, accessories, etc	...	...	...	5%	5%
Musical instruments	...	...	3%	5%	5%
Moving picture films	per foot	...	1/4-1/2 cent	5% rentals	5% rentals
Jewelry	...	...	3%	5%	5%
Sporting goods and games	...	...	3%	10%	10%
Patent medicines	...	...	2%	4%	4%
Perfumes, etc	...	...	2%	4%	4%
Chewing gum	...	...	2%	3%	3%
Cameras	...	...	3%	10%	10%
Photographic supplies	...	...	...	5%	5%
Candy	...	...	...	5%	5%
Firearms, etc	...	...	...	10%	10%
Hunting knives, etc	...	...	...	10%	10%
Daggers, etc	...	...	...	100%	100%
Electric fans	...	...	...	5%	5%
Thermos bottles, etc	...	...	...	5%	5%
Cigar holders, etc	...	...	...	10%	10%
Slot machines	...	...	...	5%	5%
Weighing machines	...	...	...	10%	10%
Liveries, etc	...	...	...	10%	10%
Hunting and riding garments	...	...	...	10%	10%
Articles of fur	...	...	...	10%	10%
Pleasure boats	...	...	...	10%	10%
Toilet soap	...	...	...	3%	3%
Sculptures, paintings, etc	...	...	...	10%	10%
Carpets, picture frames, trunks, umbrellas, fans, wearing apparel, etc.	in excess of prices enumerated in the law	...	...	10%	10%
Boats and yachts	per foot	...	50c.-$2		
Admissions, general	per 10 cents	...	1 cent	1 cent	1 cent
Admissions to cabarets	per 10 cents	...	1 cent	1 1/2 cents	1 1/2 cents
Scalper's tickets	on advance of price	...	...		
Dues	over $12	...	10%	10% [3]	10% [3]
Munitions manufacturers	on net profits	12 per cent [2]	10%	5%	

[1] For other taxes now called excises or taxes on facilities, see Table IV, STAMP TAXES.

[2] Act of 1916.

[3] Over $10.

TABLE III

SPECIAL TAXES

	Old rate	*Act of 1914*	*Act of 1916*	*Act of 1918*	*Rate in force in 1921*
Rectifiers	$100–200	...	...	...	$100–200
Liquor dealers	25–100	...	...	...	25–100
Dealers in malt liquors	20–50	...	...	...	20–50
Manufacturers of stills	50, +20 per still	...	...	...	50, +20 per still
Brewers	50–100	...	...	...	50–100
Dealers and manufacturers of					
Filled cheese	12.250.400	...	...	...	12.250.400
Adulterated butter and colored oleomargarine	48.480 600	...	...	...	48.480.600
Non-artificially colored oleomargarine	6.200.600	...	...	...	6.200.600
Manufacturers of process butter	50	...	...	...	50
Manufacturers and packers of mixed flour	12	...	...	...	12
Manufacturers or distributors of opium.	1	...	...	$3–24	3–24
Manufacturers of tobacco					
Sales not over 50,000 pounds	...	...	...	6	6
Sales 50,000–100,000 pounds	...	...	...	12	12
Sales 100,000–200,000 pounds	...	...	...	24	24
Sales not over 100,000 pounds	...	$6	...	...	...
to sales over 1 million pounds	...	2,496	...	...	...
Sales not over 200,000 pounds	...	...	$3–12	...	$3–12
Sales over 200,000 pounds	...	...	8c. per 1,000 lbs.	$24 +16c. per additional 1,000 lbs.	$24 +16c. per additional 1,000 lbs.
Manufacturers of cigars					
Sales not over 100,000 cigars	...	3	...	...	...
to sales over 40 million pounds	...	2,496	...	...	...
Sales not over 400,000 cigars	...	...	$3–12	...	...
Sales not over 50,000 cigars	...	...	...	4	4
Sales 50,000–100,000	...	...	...	6	6
Sales 100,000–200,000	...	...	...	12	12
Sales 200,000–400,000	...	...	...	24	24
Sales over 400,000 cigars	...	...	5c. per 1,000	$24 +10c. per 1,000	$24 +10c. per 1,000

TABLE III—(Continued)

SPECIAL TAXES

	Old rate	*Act of 1914*	*Act of 1916*	*Act of 1918*	*Rate in force in 1921*
Manufacturers of cigarettes					
Sales not over 1 million cigarettes...	...	12	3c. per	6c. per	6c. per
To sales over 100 million ...	...	2,496	10,000	10,000	10,000
Dealers in leaf tobacco...............	...	6–24	...	...	...
Dealers in tobacco, sales over $200.....	...	4.80	...	...	...
Bankers per $1,000 capital............	...	1	...	...	...
Brokers..........................	...	30	$30	$50–150	$50–150
Pawnbrokers......................	...	50	50	100	100
Commercial brokers.................	...	20	...	...	...
Ship brokers......................	...	...	20	50	50
Custom house brokers...............	...	10	10	50	50
Commission merchants..............	...	20	...	...	...
Corporations per $1,000 capital........	...	...	50c.	$1.00	$1.00
Proprietors of					
Theaters, museums and concert halls.	...	$12.50–100	$12.50–100	$25–200	$125–20(
Circuses........................	...	100	100	100	100
Other exhibitions.................	...	10	10	15	15
Bowling alleys and billiard rooms per alley or table...............	...	5	5	10	10
Riding academies.................	...	...	...	100	100
Automobile livery, per auto.........	...	...	...	10–20	10–20

TABLE IV

STAMP TAXES

		Old rate	Act of 1914	Act of 1917	Act of 1918
Bond and stock issues	per $100	...	5c.	5c.	5c.
Sales of stock	per $100	...	2c.	2c.	2c.
Sales on produce exchanges	per $100	...	1c.	2c.	2c.
Promissory notes	...	...	2c.	2c.	2c.
Bills of lading	...	...	1c.	...	...
Bonds (except legal)	...	...	50c.	...	...
Indemnity and surety bonds	...	...	...	50c.	50c.
Certificates of profit	per $100	...	2c.	...	...
Certificates of damage	...	...	25c.	...	...
Other certificates	...	...	10c.	...	...
Brokers' notes	...	...	10c.	...	...
Conveyances	per $500	...	50c.	50c.	50c.
Custom-house entries	...	...	25c.-$1	25c.-$1	25c.-$1
Withdrawal from bonded warehouse	...	...	...	...	50c.
Powers of attorney	...	...	10c.-25c.	25c.	25c.
Protests	...	...	25c.	...	...
Cotton futures	per pound	...	2c. [1]	2c. [5]	2c.
Proxies	...	...	...	10c.	10c.
Passage tickets		..	$1-5	$1-5	$1-5
Playing cards	per pack	2c.	...	7c. [2]	8c.
Parcels-post packages	per 25c.	...	...	1c.	1c.
Freight	...	...	...	3% [2]	3% [7]
Express packages	per 20c.	...	...	1c. [2]	1c. [7]
Passenger fares	...	...	...	8% [2]	8% [7]
Pullman tickets	...	...	1c.	10%	8% [7]
Pipe-line transportation	...	...	...	5% [2]	8% [7]
Telegraph and telephone (over 15 cents)	..	...	1c.	5c. [3]	
Insurance					
Fire, marine and casualty	per $1 of premium	...	1/2c.	1c. [6]	1c. [6]
Life	per $100 of policy	...	...	8c. [6]	8c. [6]
Property insurance issued by certain foreign corporations	per $1 of premium	...	...	...	3c.
Perfumery and cosmetics					
Price 5-25 cents	per package	...	1/8-5/8 c.	2% [4]	4%
Over 25 cents	per package	...	5/8c. per 25c.		
Chewing gum	per $1.00	...	4c.	2%	3%

[1] Imposed by the Cotton Futures Act of Aug. 18, 1914.
[2] Not called stamp taxes, but taxes on facilities, etc.
[3] No longer called stamp taxes, but taxes on facilities, etc.
[4] No longer called stamp taxes, but excise taxes.
[5] No change.
[6] No longer called stamp taxes, but taxes on insurance.
[7] Called tax on transportation and other facilities.

TABLE V

INCOME TAX ON INDIVIDUALS IN %

Increments of taxable income	Act of 1913 Surtax	Act of 1913 Total rate	Act of 1916 Surtax	Act of 1916 Total rate	Act of 1917 Additional surtax	Act of 1917 Total surtax	Act of 1917 Total rate	Act of 1918[1] Surtax	Act of 1918[1] Total rate	In force 1919-1921 Total rate
$5,000-$6,000	..	1	..	2	1	1	5	1	13	9
6,000-7,500	..	1	..	2	1	1	5	2	14	10
7,500-8,000	..	1	..	2	2	2	6	2	14	10
8,000-10,000	..	1	..	2	2	2	6	3	15	11
10,000-12,000	..	1	..	2	3	3	7	4	16	12
12,000-12,500	..	1	..	2	3	3	7	5	17	13
12,500-14,000	..	1	..	2	4	4	8	5	17	13
14,000-15,000	..	1	..	2	4	4	8	6	18	14
15,000-16,000	..	1	..	2	5	5	9	7	19	15
16,000-18,000	..	1	..	2	5	5	9	7	19	15
18,000-20,000	..	1	..	2	5	5	9	8	20	16
20,000-22,000	1	2	1	3	7	8	12	9	21	17
22,000-24,000	1	2	1	3	7	8	12	10	22	18
24,000-26,000	1	2	1	3	7	8	12	11	23	19
26,000-28,000	1	2	1	3	7	8	12	12	24	20
28,000-30,000	1	2	1	3	7	8	12	13	25	21
30,000-32,000	1	2	1	3	7	8	12	14	26	22
32,000-34,000	1	2	1	3	7	8	12	15	27	23
34,000-36,000	1	2	1	3	7	8	12	16	28	24
36,000-38,000	1	2	1	3	7	8	12	17	29	25
38,000-40,000	1	2	1	3	7	8	12	18	30	26
40,000-42,000	1	2	2	4	10	12	16	19	31	27
42,000-44,000	1	2	2	4	10	12	16	20	32	28
44,000-46,000	1	2	2	4	10	12	16	21	33	29
46,000-48,000	1	2	2	4	10	12	16	22	34	30
48,000-50,000	1	2	2	4	10	12	16	23	35	31
50,000-52,000	2	3	2	4	10	12	16	24	36	32
52,000-54,000	2	3	2	4	10	12	16	25	37	33
54,000-56,000	2	3	2	4	10	12	16	26	38	34
56,000-58,000	2	3	2	4	10	12	16	27	39	35
58,000-60,000	2	3	2	4	10	12	16	28	40	36
60,000-62,000	2	3	3	5	14	17	21	29	41	37
62,000-64,000	2	3	3	5	14	17	21	30	42	38
64,000-66,000	2	3	3	5	14	17	21	31	43	39
66,000-68,000	2	3	3	5	14	17	21	32	44	40
68,000-70,000	2	3	3	5	14	17	21	33	45	41
70,000-72,000	2	3	3	5	14	17	21	34	46	42
72,000-74,000	2	3	3	5	14	17	21	35	47	32
74,000-75,000	2	3	3	5	14	17	21	36	48	44
75,000-76,000	3	4	3	5	14	17	21	36	48	44
76,000-78,000	3	4	3	5	14	17	21	37	49	45
78,000-80,000	3	4	3	5	14	17	21	38	50	46
80,000-82,000	3	4	4	6	18	22	26	39	51	47
82,000-84,000	3	4	4	6	18	22	26	40	52	48
84,000-86,000	3	4	4	6	18	22	26	41	53	49
86,000-88,000	3	4	4	6	18	22	26	42	54	50
88,000-90,000	3	4	4	6	18	22	26	43	55	51
90,000-92,000	3	4	4	6	18	22	26	44	56	52
92,000-94,000	3	4	4	6	18	22	26	45	57	53
94,000-96,000	3	4	4	6	18	22	26	46	58	54
96,000-98,000	3	4	4	6	18	22	26	47	59	55
98,000-100,000	3	4	4	6	18	22	26	48	60	56
100,000-150,000	4	5	5	7	22	27	31	52	64	60
150,000-200,000	4	5	6	8	25	31	35	56	68	64
200,000-250,000	4	5	7	9	30	37	41	60	72	68
250,000-300,000	5	6	8	10	34	42	46	60	72	68
300,000-500,000	5	6	9	11	37	46	50	63	75	71
500,000-750,000	6	7	10	12	40	50	54	64	76	72
750,000-1,000,000	6	7	10	12	45	55	59	64	76	72
1,000,000-1,500,000	6	7	11	13	50	61	65	65	77	73
1,500,000-2,000,000	6	7	12	14	50	62	66	65	77	73
Over 2,000,000	6	7	13	15	50	63	67	65	77	73

[1] The Act of 1918 fixes the normal rate at 12%, except on the first $4,000, when it is 6%. For 1919 and thereafter the rates are 8% and 4% respectively.

TABLE VI—ESTATE TAX

Net estate	Act of 1916	Act of Mar. 3, 1917	Act of Oct. 3, 1917 Additional	Act of Oct. 3, 1917 Total rate	Act of 1918
Below $50,000	1	1½	½	2	1
50,000–150,000	2	3	1	4	2
150,000–250,000	3	4½	1½	6	3
250,000–450,000	4	6	2	8	4
450,000–1,000,000	5	7½	2½	10	..
450,000–750,000		....	....	..	6
750,000–1,000,000		....	....	..	8
1–1½ millions		....	....	..	10
1½–2 millions		....	....	..	12
1–2 millions	6	9	3	12	..
2–3 "	7	10½	3½	14	14
3–4 "	8	12	4	16	16
4–5 "	9	13½	4½	18	18
Over 5 "	10	15	....	..	..
5–8 "	10	15	5	20	20
8–10 "	10	15	7	22	22
Over 10 "	10	15	10	25	25

TABLE VII—INTERNAL REVENUE RECEIPTS (000 omitted)

	1915	*1916*	*1917*	*1918*	*1919*	*1920*	*1921*
Total	$413,522	512,723	809,394	3,698,956	3,850,150	5,407,580	4,595,007
Income and profits tax	.....	.....	...	2,839,028	2,600,763	3,956,936	3,225,791
Excess profits	....	....	37	1,638,747[1]	1,320,000[2]	2,500,000[2]	1,250,000[2]
Income tax	79,256	124,938	359,648	1,195,190[1]	1,231,000[2]	2,000,000[2]	1,975,000[2]
Corporations	38,320	56,994	179,573	503,698[1]	653,700[2]	.....	.....
Individuals	40,936	67,944	173,387	691,492[1]	1,127,720[2]	.....	.....
Munition mfrs.	.....	.....	27,663	13,797	.....	.....	.....
Miscellaneous	.....	.....	.....	859,928	1,249,387	1,450,644	1,369,210
Distilled spirits	144,620	158,682	476,119	443,840	483,051	67,271	78,471
Fermented liquors	79,329	88,771	91,897	125,728	117,504	41,744	17
Nonalcoholic beverages	.....	.....	.....	.....	7,172	57,461	58,673
Tobacco	79,764	88,064	103,202	156,189	206,003	294,777	253,990
Stamps	20,494	38,110	8,254	17,538	33,552	84,348	72,468
Sales by P. M.	.....	.....	.....	.....	.....	24,438	20,881
Bonds, conveyances, etc.	.....	.....	.....	12,949	18,747	35,277	32,671
Capital stock transfers	.....	.....	.....	2,236	7,541	13,372	8,791
Produce exchanges	.....	.....	.....	2,354	7,264	8,172	7,522
Playing cards	.....	.....	.....	1,276[3]	2,092[3]	3,088	2,604
Special taxes	4,967	6,908	15,709	56,304	89,183	105,480	92,446
Capital stock	.....	.....	10,471	24,996	28,776	93,020	81,514
Admissions & Dues	.....	.....	.....	28,616	54,851	81,929	95,883
Estates	.....	.....	6,076	47,412	82,029	103,636	154,040
Public utilities	.....	.....	.....	70,737	237,840	289,348	301,512
Freight	.....	.....	.....	30,002	116,345	130,785	140,019
Express	.....	.....	.....	6,451	14,301	17,597	17,094
Passenger	.....	.....	.....	24,306	77,791	98,786	97,482
Pullman	.....	.....	.....	2,236	.....	.....	.....
Oil by pipe	.....	.....	.....	1,433	5,602	8,426	8,485
Telegraph & Tele.	.....	.....	.....	6,299	17,879	26,631	27,360
Insurance	.....	.....	.....	6,492	14,509	18,422	18,992
Excises, Mfrs.	.....	.....	.....	39,069	82,425	267,883[4]	229,322[4]
Autos	.....	.....	.....	23,981	48,834	143,923	115,546
Pianos	.....	.....	.....	2,422	4,773	13,624	11,568
Candy	.....	.....	.....	.....	.....	23,142	20,437
Articles of fur	.....	.....	.....	.....	.....	15,311	9,081
Movies	.....	.....	.....	.....	4,833	4,381	6,008
Firearms	.....	.....	.....	.....	.....	4,645	3,702
Excises, Dealers	.....	.....	.....	993	6,147	51,738[5]	.....[5]
Jewelry	.....	.....	.....	.....	1,794	25,864	24,304
Carpets, apparel, etc.	.....	.....	.....	.....	395	17,903	20,375
Perfumes, etc.	.....	.....	.....	.....	1,500	6,427	5,801

[1] For the calendar year.

[2] Estimates, as the details of the income and profits tax are not known until the statistics for the calendar year are published, generally two or three years later.

[3] Included under the excise taxes. manufacturers.

[4] Includes all excises.

[5] Included in excises, manufacturers.

CHAPTER XXIII

LOANS VERSUS TAXES IN WAR FINANCE [1]

THE fiscal problems of the war may be divided into those of a general and of a specific character. War expenditures can be

[1] This chapter is reprinted with a few changes from the paper published in the volume entitled "Financing the War," *Annals of the American Academy of Political and Social Science*, volume lxxv., January, 1918, pp. 52–82. In the same volume will be found two articles which take a different view: O. M. W. Sprague, "Relationship between Loans and Taxes in War Finance," pp. 83–89, and R. G. Blakey, "Shifting the War Burden upon the Future," pp. 90–104. The fundamental ideas of the present writer will also be found in "How to Finance the War," *Columbia War Papers*, no. 7, 1917, and in "Our Fiscal Policy," in *Financial Mobilization for War, Papers presented at a Joint Conference of the Western Economic Society and the City Club of Chicago, June 21st and 22d, 1917.* In the same volume will be found the paper by E. Dana Durand, "Taxation *vs.* Bond Issues for Financing the War," which takes the opposite standpoint. The discussion was continued by F. F. Anderson, in "Fundamental Factors of War Finance," *Journal of Political Economy*, vol. xxv. (1917), p. 857; H. J. Davenport, "The War Tax Paradox" in *American Economic Review*, vol. ix. (1919), p. 34; and Jacob Viner, "Who Paid for the War" in *Journal of Political Economy*, vol. xxviii. (1920), p. 46. *Cf.* E. L. Bogart, *War Costs and Their Financing*, New York, 1921, esp. ch. x.

In Great Britain we may refer to F. Y. Edgeworth, *Currency and Finance in Time of War*, Oxford, 1917; W. R. Scott, *The Adjustment of War Expenditure between Taxes and Loans*, Glasgow, 1917; the chapter entitled "The Financial Burdens of To-day and of To-morrow" in *Economic Problems of Peace after War*, Second Series, Cambridge, 1918; and "Some Aspects of the Proposed Capital Levy" in the *Economic Journal*, vol. xxviii. (1918), esp. pp. 250–258. Both of these writers agree with the view presented in the text. Professor Pigou is responsible for "The Economics of the War Loan," in the *Economic Journal*, vol. xxvii. (1917), p. 16, and for several chapters on the subject in his *Economics of Welfare*, 1920, pp. 643–664. His views are discussed *infra*, p. 730.

The Italians have devoted considerable attention to the subject. *Cf.* A. de Viti de Marco, *Contributo alla teoria del prestito pubblico* in *Saggi di economia e finanza*, Rome, 1889; M. Pantaleoni; "Imposta e debito in riguardo alla loro pressione" in *Giornale degli Economisti*, July, 1891, and reproduced in *Scritti vari di Economia*, vol. iii., Roma, 1910; M. Marsilj-Libelli, *Pressione comparata del prestito pubblico e dell'imposte sulle economie private* in *Atti dei Georgofilil*, Florence, 1910; and Benvenuto Griziotti, *La diversa pressione tributaria del prestito e dell'imposta*, in *Giornale degli Economisti*, May, 1917, and separately, Rome, 1917.

met in three ways: by taxes, by loans, or by paper money. The specific problems have to deal with the nature and the details of each of these expedients; the general problem is concerned with the principles that underlie the preference among the respective methods. Inasmuch as paper money is by common consent to be regarded as the last resort, the general problem at issue here pertains to the choice between loans and taxes and the relative proportions in which each is to be employed.

If we look at the facts, we observe a marked change in modern warfare. In former times, whether in classic antiquity or in the Middle Ages, the expenses of war were defrayed in large measure out of accumulated funds or treasures reënforced by taxes, and were reimbursed to the victor by the booty of war and the indemnities imposed upon the vanquished. Since the development of public credit, especially since the middle of the eighteenth century, loans have taken the place of the accumulated treasure and taxes have been utilized chiefly for the purpose of raising the interest on the war loans and of furnishing in addition a more or less considerable amortization quota.

The facts of the present war are no different. During the early years of the war Great Britain raised by taxation slightly over seventeen per cent of her war expenses; Italy, although also levying heavy taxes, raised a still larger proportion than England by loans; in Germany only an insignificant fraction of the war expenses was met by taxes; in France, as a result partly of the occupation of its territory by the enemy, the taxes levied during the war did not suffice even to pay the ordinary peace expenses; while Russia was in a still worse position. Although there is indeed a notable difference between the zero of France and the seventeen per cent of Great Britain, the fact remains that in all the countries, without exception, the overwhelming proportion of war expenditures was met through loans. The same is true of the United States.[1]

Early in the war, however, an American economist [2] made the following statement: "I am strongly of the opinion that a great modern war, enormously costly as it is, can and should be mainly, if not entirely, financed from the proceeds of taxes collected during its progress." Similar opinions were voiced by others and found expression in Congressional speeches, and

[1] See the facts *infra*, pp. 772 *et seq.*

[2] O. M. W. Sprague, "The Conscription of Income," in the *Economic Journal*, March, 1917, p. 2.

a more or less faint echo of that pronouncement was even audible in certain statements emanating from the executive branch of our government.

Why have the actual methods diverged so greatly from these suggestions? How does it happen that the statesmen and the legislators in every belligerent country, including our own, have done the opposite? Shall we convict the European and American statesmen of folly and fiscal madness? Or is it perhaps true that the suggestions, so unavailingly made to the contrary, have been based upon an inadequate analysis?

This is the problem to which we shall now address ourselves.

I. *What are War Costs?*

The first point in our analysis is to ascertain what is meant by the costs of war. It is obvious that a distinction must be made between the money costs and the real costs of a war. The money costs of a war are the actual outlays of the government for war purposes, that is, the surplus above the general expenditures in time of peace, making due allowance for changes in the purchasing power of money. The real costs of a war, on the other hand, are to be calculated very differently. When the ordinary man speaks of wealth he thinks of accumulated capital. The more sagacious thinker, however, is aware that the real wealth of a community consists in larger part of the results of current production. Accumulated capital is of importance chiefly as an aid to current production. It has been calculated that the world is always within a year and a half of starvation. If current production were suddenly to cease, the world's stores of food and other products would barely suffice for eighteen months. A wealthy country is one where the consumption of the people is great and variegated and where the current production is so large that there will still be a substantial surplus susceptible of being converted into capital for future production and into an environment which will spell increasing welfare and civilization. A great war interferes rudely with the results both of past accumulation and of current production. The real costs of a war are to be measured by the diminution of the social patrimony and by the diversion of current social output from productive to unproductive channels, *i. e.*, by changes both in the fund of accumulated wealth and in the flow of social income.

In drawing up the balance sheet we should have to put on the one side the diminution of the fund of wealth as represented by (a) the destruction of private property, (b) the loss of government accumulations, (c) the impairment of natural resources and (d) the decrease in the social output due to the reduction of the labor force by military service and the fortunes of war. On the other side of the ledger, indeed, we should have to put such capital items as (a) indemnities or booty, and (b) the acquisition of new territory; and on the income side, the results of (c) speeding up of production, (d) the more favorable economic situation attained by the political results of the war, and (e) changes in the methods of industry and the relation of capital and labor which may conduce to greater efficiency and increased output.

Although not all of these items are susceptible of being put in terms of dollars and cents, the real costs of a war may be characterized as the balance of the debit side over the credit side in the above account.

While this contrast between the money cost and the real cost of the war is important, it does not yet go to the root of the matter. In order to grasp what is meant by the real costs of a war, we must revert to the distinction familiar to the student, but so often neglected in popular discussion, between objective and subjective costs.

By objective costs are meant the costs incorporated in the goods, commodities and services that are used for the war, that is, the money value of all materials consumed and all services furnished for war purposes. These costs have grown immensely in recent times: not only are the munitions of war infinitely more costly than in former times, but also less durable. The bigger the gun, the shorter is its life; the more elaborate the aeroplane, the greater the chance of its destruction; the better the sanitary methods, the more frequent is the casting aside of uniforms; the more complete the application of science, the more rapid are the ravages of war by both land and sea. Not only are initial expenses immensely greater, but the sheer waste by destruction grows with every forward step in efficiency. The objective costs of war are so prodigious that they are obvious to all.

In contradistinction to the objective costs, however, are the subjective costs. The essential idea here is that of sacrifice. The production of everything costs some sacrifice and all

sacrifice involves pain, either the pain of doing something distasteful or of refraining from doing something pleasurable. Sacrifice in other words is involved both in labor and in abstinence. The surplus of results over subjective costs constitutes the welfare or the real wealth, both material and immaterial, of society. In a community based upon slavery or where the laborers, with an abject standard of life, are compelled to work sixteen hours a day, there may be a great surplus of production and in that sense great wealth. If, however, slavery is abolished or the laborers acquire a shorter working day and a higher standard of life, not only may there be the same output of material things as before, but there will be a greater surplus over subjective costs, and, as a consequence, an increased communal welfare and a higher stage of civilization.

As a result of the machinery of our social order subjective costs are commonly translated into objective and money costs. If a machine is invented which cuts in half the period needed for the production of a particular commodity, we speak of halving its cost. Instead of two men being required to accomplish the result, only one man is now needed. So far as the community is concerned, the subjective cost or sacrifice is reduced; and under a state of competition, this decrease in subjective costs will reflect itself in smaller objective costs and lower prices. So, in the same way, just as the greater efficiency of the laborer will result in a larger output of material commodities, the greater abstinence involved in the ordinary economy practiced by the members of a community will be followed by an increased accumulation of productive capital. The subjective costs involved in economy are undoubted, but the additional results which ensue from the practice of economy are so much greater that there remains a substantial surplus. In other words, net sacrifice or burden is diminished.

The real wealth of a community depends upon net sacrifices or subjective costs. Where the same output is attended with less sacrifices we have prosperity. Where increased sacrifices result in still greater output we again have the prosperity that goes with lessened net subjective costs. When, however, economy changes into privation, the increased material results may be too dearly purchased: although there may be more material wealth for the present, there is less real wealth or welfare because there is more net sacrifice. So, in the same way, when increase of production is attended with the sapping of the vitality

of the labor force, the nominal efficiency really becomes inefficiency and the greater material wealth of the present signifies less real wealth or welfare. The total net burdens upon the community are greater.

The important criterion in the economic welfare of a community is therefore the subjective cost or sacrifice. This is as true in war as in time of peace. Just as the subjective cost of an individual consists of the effort involved in labor and the abstinence involved in the foregoing of enjoyments, so the subjective costs of a community due to a war consist of the burdens of additional labor which it must expend and the diminished consumption of goods and services which it must forego. The objective costs of a war are material commodities and services; the subjective costs of a war constitute the real burdens resting on the community. The true costs of a war are the net sacrifices or subjective burdens which result from the transition from a peace economy to a war economy, and which are connected with the fundamental processes of production and consumption. They consist, on the one hand, of all the efforts involved in the transfer of enterprise and investments from the ordinary channels of production to the new fields of primary importance in the war. They consist, on the other hand, of all those efforts involved in the reduction and the change of consumption which will serve to counterbalance, in part at least, the inevitable reduction of social output. The net result measured in terms of aggregate sacrifice or subjective cost constitutes the real burden of a war. The problem that confronts us is to analyze the results of various fiscal expedients upon these changes in production and consumption from the point of view of the subjective costs or the real burdens resting on society.

II. *Can War Costs be Diminished in the Present or be Shared with the Future?*

After this preliminary explanation we may proceed to consider how the costs of a war can be diminished in the present and in what way, if any, they can be shared with the future.

So far as objective costs are concerned, it is manifest that they belong, for the most part, to the present. The services must be performed by men now living and the commodities consumed in the war must be produced before they are con-

sumed. In several respects, however, the present may benefit at the expense of the future, even so far as objective costs are concerned. These considerations deal respectively with capital and with labor.

In the cost of production we ordinarily include sums set aside for depreciation of plant. It is possible, however, that the exigencies of the war situation may require such an immediate increase of output as to divert to current production the funds which would otherwise be devoted to the maintenance of plant. The result is that the future will possess a less effective plant than would otherwise be the case. Or, in the second place, the capital diverted to purposes of war production may become useless after the return of peace. Thousands of munition plants, for instance, may have been constructed solely for war purposes with machinery that it would be difficult or even hopeless to convert to other purposes. The capital which would otherwise be available at the conclusion of the war for peace production will to this extent have been lost. The production in the future will be less than would otherwise have been the case.

What is true, however, of capital, is equally true of labor. It is possible that the speeding up of production involves such a strain on the laborers, resulting from long hours, night work and unremitting toil, as to impair their health and transmit to the future a body of workmen less efficient than they would otherwise have been. It may take some time, either by the more careful handling of the then existing workmen, or by the immigration of men of a higher standard and stronger physique, before the balance is restored. And, on the other hand, while a diminished consumption is assuredly desirable during a war, the enforced decrease of consumption which may result from the fortunes of war may bring about such privation in the mass of the community as to sap their energies and reduce their future efficiency.

In all of these ways, the burden of the present may be lightened at the expense of the future. There is more production, that is, more commodities and services now; but there will be relatively less in the future. Even in the case of objective costs the present may benefit at the expense of the future.

Subject to these limitations and exceptions, however, it may be said that the objective costs of a war are, in the main, borne by the present. This is true irrespective of whether the

expenditures designed to furnish these commodities and services are met by loans or by taxes.

When we deal with subjective costs, however, the situation is very different. Subjective costs may be reduced without any of the burden being shifted to the future; or they may be diminished while a part of the burden is borne by the future. It is obvious that neither of these results can be obtained by the process of taxation. The tax imposed upon the present generation may indeed have some repercussion upon the future. If an excessive tax is imposed upon capital, it may so reduce existing resources as to make future production smaller. Even if the tax is not excessive, the taxpayer, instead of decreasing consumption or paying the tax out of current income, may draw on the funds which he would otherwise have devoted to productive purposes. Or, finally, if an excessive tax is imposed upon incomes or profits, it may so diminish the tendency to enterprise that the baneful consequences will endure. In all these cases, however, although the future undoubtedly suffers, there is no diminution in the burdens that rest upon the present. The present taxpayers bear the burden, even though the future taxpayers also bear a burden.

Is the same true in the case of loans? Can the burden upon the present be lightened by the issue of government loans? Are the subjective costs or sacrifices of the community in any way lessened by government borrowing? This brings up for consideration the theory of public credit.

The theory of credit, as it has been worked out by economists, is in reality simple. Credit is a phenomenon or transaction in which a part takes place in the present and a part in the future. If I lend a man money, I turn over to him now a certain sum and he turns over to me in the future the equivalent of that sum. When the sum has been paid, the transaction is complete. If we deal with public, instead of with private, credit, the situation is identical. The funds are turned over now by certain classes in the community who loan the money to the government and the transaction is concluded in the future, when the taxpayers furnish the money to return it to the bondholders.

How does it happen then that the utilization of credit diminishes the burden upon the present? How can the subjective costs of the war be lessened for the community?

In the case of private credit the subjective sacrifice of the individual is clearly diminished. This is obviously true of

productive credit, for otherwise credit would not have become so vital a fact in our modern industrial life. The reason why the business man borrows to-day is chiefly because he thinks that with the borrowed funds he can secure such a return as to insure an enhanced profit even after paying all interest as well as repaying the capital borrowed. The credit, therefore, in so far as it enables him to purchase more goods with the same outlay, or—what is the same thing—the same amount of goods with a smaller outlay, lessens his subjective cost. Moreover, not only is his subjective cost or sacrifice less, but his objective cost or outlay as compared with the return, is also smaller.

Even, however, if we deal only with consumption credit, that is, with money borrowed for mere purposes of consumption, the borrower may enjoy a gain. Although he is thoroughly aware of the fact that he will have to repay in the future, with interest in the meantime, the precise sum that he now borrows, he is nevertheless anxious to borrow. This is due to two facts: an underestimate of the future, and the possibility of repayment in instalments.

His sense of immediate need is much stronger than his recognition of the sacrifice that he will have to make in the future in order to repay the loan. It is the same feeling that overcomes us when we compare the foregoing of a good dinner to-night with the foregoing of a good dinner a year hence. Our present sense of sacrifice, that is, our real subjective cost, is smaller in the one case than in the other. This is true even though we may, at the end of the year, regret our action. In ordinary cases, however, the action will not be regretted but will be repeated another year.

But, secondly, and more important, private credit diminishes subjective costs not only by the mere process of deferring payment but by making possible repayment in instalments. The essence of the situation is found here in the gradualness of the repayment. The aggregate burden of gradual repayment is less than the sacrifice involved in providing for the whole of the original amount outright at once. The individual who borrows may incur a gain despite the obligation ultimately to return the same aggregate amount in the future. If he did not incur this gain, he would not continue to borrow.

We are now in a position to grasp the social importance of credit. Credit increases prosperity. If used for productive pur-

poses, credit, while indeed not capital, works like capital and constitutes an aid to production. It renders possible the same amount of output with a smaller cost or sacrifice. It accomplishes this by taking the funds out of the hands of those to whom it is worth relatively little and putting it into the hands of those to whom it is worth more because they make it yield more. The man who lends money at six per cent does so presumably because he has a surplus capital from which he is content to receive six per cent interest. But the man who borrows the fund expects to make more than six per cent interest and to retain the surplus in the shape of profit. Could the lender utilize the fund profitably in his own business he would not lend the fund. But even where credit is utilized for purely consumption purposes, it is equally advantageous, because by deferring payment and by rendering possible repayment in instalments rather than in a lump sum, it lessens subjective costs or sacrifices. The social utility of credit is therefore quite clear. It increases the wealth of the community by lessening the subjective sacrifices of certain individuals and putting at the disposal of the community funds where they will be utilized to the greatest advantage, thus decreasing costs and increasing output. Society as a whole is thereby enabled to employ those services with which it can more easily dispense.

The truth of this assertion is not invalidated by the fact that credit may be abused. If the man who borrows at six per cent puts the money into a business which does not earn six per cent, the community, as well as himself, suffers for his mistake. So, in the same way, if an improvident individual borrows for consumption purposes and finds that he becomes more and more hopelessly entangled with the passage of time, he may find it impossible to meet the debt, even in instalments, and his easy-going reliance upon the future may cause his ruin as well as loss to the lender. The fact, however, that an essentially sound institution may be abused is no argument against its essential soundness. Credit, like speculation, would not have become the outstanding feature of our present economic organization if it did not fulfill a socially useful function. The modern economy is essentially a credit economy.

Public credit shares this character. The chief difference between public and private credit is in the relation of consumption credit to production credit. While the government, like the individual, often borrows for productive purposes, as for a

government railway or a municipal subway, most existing national loans are the result of consumption credit, utilized to pay the expenses of war or to cover current deficits. It is fairly well agreed that just as a prudent individual ought not to borrow for purposes of ordinary consumption, so the government ought not to borrow to meet its current expenditures. The real differences arise when we consider extraordinary expenditures.

There are three points in which public credit differs from private credit. In the first place, extraordinary expenditures for unusual consumption are not so apt to occur in the case of the individual as in the case of the government. Most individuals are able to provide a reserve fund against a rainy day. Government revenue, however, ought properly never to exceed current expenditures. As a consequence, when an extraordinary emergency arises, as a war, the utilization of consumption credit becomes legitimate. In the second place, the individual lives only his own life; if he borrows largely for consumption purposes he will not always find it easy to repay the debt. The state, on the contrary, is eternal. The government, accordingly, has a much longer time in which to pay off a debt. If, for any reason, it becomes desirable to postpone the payment of the debt to the distant future, the justifiability may be stronger in the case of the government than in the case of the individual.

In the third place, what seems to be consumption credit may, in the case of the government, partake of the characteristics of production credit. A legitimate war is either for defensive purposes, that is, to maintain the existence of the state, or for offensive purposes, in order to procure for the state certain territories or rights to which it thinks itself entitled. Since in both of these cases a foundation is laid for continued or even greater prosperity, the expenditures may in a sense be called productive in their nature. Whether a particular war is actually of that character may be a question; but surely no nation will enter upon a great war unless it is deemed legitimate. And if the general sentiment of the nation justifies the war, if the ends to be achieved transcend the sacrifices that are incurred, the war expenditures may be considered in the broader sense of the term productive.

For these three reasons, therefore, public credit may be considered even more important than private credit. Just as

private credit is socially useful or productive of wealth and welfare, so public credit may be at least equally beneficial. Its utility consists in the fact that, through borrowing from those in possession of the capital rather than taxing all the members of the community, whether or not they have the capital, it lessens subjective costs or sacrifices and puts at the disposal of the government those services in the community with which it can most easily dispense. In the case of private credit, the benefit accrues to the borrowers; in the case of public credit, the benefit accrues to the non-subscribers to the loan, who would otherwise be taxed. Since there are always some non-subscribers to a loan and since the subscribers suffer no burden, there remains a net benefit which accrues to the community, represented in this case by the government as borrower. Credit, both private and public, is productive because it normally benefits the borrower and does not injure the lender.

It might be claimed that the advantages of private credit do not attach to public credit because in the one case we are dealing with different classes in the community and, in the other, with the community as a whole. Why would not the same advantages be secured, it might be said, by taking from the possible lenders the same amount in the shape of taxes? This argument, however, is really illicit. For the situation contemplated is not only most unlikely but virtually impossible. Under every system of taxation which has hitherto existed—in democracies as elsewhere—we find some taxes at least levied on business, on consumption, on exchange and on other sources than wealth. Even, however, if the tax system were to be so changed as to consist exclusively of taxes on accumulated wealth and income, it by no means follows that the funds would be forthcoming from the individual taxpayers in precisely the same proportions that they would have been supplied by the individual bondholders. For some recipients of large incomes, at least, would surely give up a greater sum as an investment bearing interest, than they would hand over as a forced contribution representing a dead loss. The psychology of the situation consists in the difference of the reaction to a voluntary, as contrasted with a compulsory, act. Even if only a few individuals contributed, it would still remain true that the utilization of public credit would in this way put at the disposal of the government the services in the community most easily dispensed with. In order to invalidate this statement it would

be necessary for the government to take by taxation from each individual absolutely everything above the necessary means of subsistence. Only then would this particular argument as to the advantage of loans over taxes lose its force.

Loans thus lessen subjective costs because the funds are worth more to the non-lenders than to the lenders. This is true despite the fact that the loans must eventually be repaid out of taxes, which, as we have seen, will necessarily fall on the non-lenders as well. For although the taxpayers of the future have indeed to repay the loan, they are not compelled to pay the amount all at once, as would be necessary in the case of the sums raised immediately by taxation. Just as in private credit the aggregate burden of gradual repayment is less than the sacrifice involved in outright provision of the original amount, so in the case of public credit the social sacrifice involved in the periodic payment of the smaller sum represented by the interest and amortization charge is less than the burden involved in providing the entire amount in a lump sum. The phenomena of interest and of credit, by their very nature, imply that the burden of a successive series of partial payments is less than the burden of the total original payment. Just as the individual who borrows may incur a gain, despite the obligation to return the same amount in the future, so the community which borrows may incur a similar gain. This net gain in the case of public credit is represented by the smaller burden involved in the amortization quota.

An objection to the above argument has been raised by Professor Patten, who casts doubt upon the possible postponement of such subjective costs. "Were they stated," he tells us,[1] "they would be found to be feelings which we compensate in the future at our peril." On the contrary, we may say, not only is there no peril involved, but the postponement of such subjective costs will normally exert a positive influence on present objective costs.

The statement that the costs of a war, from the objective point of view, must be met in the present is of course entirely

[1] S. N. Patten, "Mandeville in the Twentieth Century," *American Economic Review*, viii. (1918), p. 92. *Cf.* the answer by the present writer, "Who is the Twentieth Century Mandeville?" *Ibid.*, pp. 339, *et seq.* Professor Patten is compelled to take the extraordinary position that, save in the case of short-time bank credit "the nearer we come to eliminating credit, the better for the nation" (p. 94). This would put us back into the Middle Ages.

true. The guns must be manufactured now and the supplies must be forthcoming now. It is now that they are needed and not in the future. But has any one in his senses ever thought of denying that fact? And is there any difference between public credit and private credit in this respect? If we buy furniture in instalments, can any one deny that the furniture must be produced now? If a railroad secures its capital in large part by the issue of fifty-year bonds, does any one deny that the railroad must be built now? If we erect a skyscraper to an overwhelming extent by the issue of long-time securities, does that imply that the skyscraper must not be built now? In all these cases, the articles or commodities are produced now; but the essential point is that they are not paid for now, at least not in cash: they are paid for in promises; or, to put it more exactly, the cash handed over to the sellers of material and labor is almost entirely borrowed. There is a present production but a future payment. The objective costs must indeed be met now—the labor must be hired and the materials secured. These costs cannot be postponed: that goes without saying. But the subjective costs of the producer are lightened. In fact, they are lightened to such an extent that they react upon the objective costs. If the furniture buyer could not pay for the furniture in instalments he would not buy the furniture at all; and with the lessened demand for the furniture, there would be less produced. If the proposed railway could not market its bonds, the railway would not be built. If the real-estate operator could not borrow through his first, second, and third-mortgage loans, the skyscraper would not be constructed. In every case, the increase of the subjective costs which would ensue upon the abolition of credit would react upon the objective costs. If there were no credits in these cases there would be no production; or if there were any production, it would be at a very much higher cost; that is, there would be less production. Credit, in other words, increases production by decreasing costs. The decrease of subjective individual costs may lead to a decrease of objective social costs. The diminution of the total aggregate sacrifice is equivalent to, or is followed by, a greater social production.

But if all this is true of private credit, why is it not equally true of public credit? If it is true of a railway in private hands, why is it not true of a railway that belongs to the government? And if it is true of public credit in peace time, why is it not true

of public credit in war time? As a matter of fact, it is as true of war finance as of peace finance. The guns and the supplies must be furnished now. But if we were to rely entirely upon taxes and not at all upon loans, the point is that there would be far less likelihood of their being produced now. They are produced now because they can in large part be paid for in the future through the use of public credit. If they had to be paid for now in cash raised by taxation, not so much would be produced because the excessive taxes would cripple production. As Professor Scott, of Glasgow, so well puts it: "If the choice is between immediate and deferred taxation, why should the burden be postponed, would it not be better to meet it at once and leave the future unembarrassed?" His answer is this: "The mere fact of giving the taxpayer time to adjust himself to a new and heavy burden will lighten it materially for him. Also industry, in time, has a chance of expanding to provide a part of the new imposts."

It is clear then, not only that the lessening of the subjective costs, that is of the burden of paying for the supplies, is not necessarily attended by perils, as Professor Patten thinks, but that as a matter of fact, this postponement of payment involved in the diminution of subjective costs may mean not only a smaller total aggregate sacrifice but even a diminution of the objective costs in the present. Public credit, in other words, may give us more guns and more supplies now.

If, then, it is true that the utilization of public credit may involve a lessening of subjective costs or real burdens upon the community, can it in the second place accomplish this by transferring a part of the burden to the future?

It might plausibly be argued that while it is true that the future taxpayer suffers a burden in so far as he has to pay taxes in order to raise the funds which are due to the bondholder, the only result is a transfer of the burden from one class in the community to the other. The taxpayers, it might be said, suffer a disadvantage, but the bondholders who have their loan repaid to them secure the benefit. Since the benefits counterbalance the disadvantages there is no net burden.

This argument, however, is fallacious. When the bondholder invests in a loan he suffers, it is true, a sacrifice in the sense of giving up the funds which he might otherwise employ. This sacrifice indeed is compensated, and more than compensated, by a benefit. The benefit, however, that accrues to him is to

be measured by the annual interest that he receives on the bond. If he had not invested in the government bond he would have invested in something else. In any case he would simply have gotten interest on his capital; and it is immaterial whether his capital is represented by a deposit account in the bank or by a private security or a public bond. The benefit that the bondholder receives in return for the sacrifice of yielding the money is the accumulated annual interest on the bond. By the time that the bond falls due there is no more benefit accruing to him. The bond is always salable at the market price. Even before it falls due, the holder can dispose of it and get as much as he could have gotten by waiting until the expiration of the loan. If, as often happens, the bond commands a premium, he could even get more by selling it beforehand. In reality, therefore, we ought not to speak of any benefit accruing to the bondholder when his bond is paid off.

But even if we declare this repayment a benefit, it does not follow that the benefit to the bondholder counterbalances the burden to the taxpayer. There is no such equilibration between the two. For the possible burden on the lender, who foregoes the principal but receives interest, is assuredly less than the actual burden on the taxpayer who is compelled to pay both principal and interest. There remains, therefore, a net burden on the taxpayer and there is no counterbalancing of the taxpayer's burden by the bondholder's benefit.[1]

[1] Professor Pigou, in *The Economics of Welfare*, 1920, pp. 655–658, takes exception to the above argument on the ground not that the bondholder secures a benefit but that the taxpayer suffers no loss. For the taxpayer, according to him. simply converts an annual interest charge into the payment of a capitalized sum. This criticism, however, is doubly illicit. In the first place, what we have been discussing is the contrast between the tax on the present generation and a loan which must be met by a tax on the future generation. If there had been no loan, there would be no tax at all, either to defray the interest or to repay the loan. The burden upon the future taxpayer is thus a result of the placing of the loan now: it has nothing to do with the question whether the capital raised by the loan is conserved or consumed. If there had been no loan, the future taxpayer would have to pay nothing for either interest or reimbursement of the principal. In the second place, there is a difference in the subjective burden between paying interest on the loan and repaying the capital of a loan. It is the difference between raising a sum at once or paying it in instalments. It represents the saving in the subjective burden that is due, as explained above, to the utilization of credit. Thus on both counts Professor Pigou fails to make good his contention.

On the question of whether it is possible through the utilization of a

There is another fallacy lurking in the statement that the burden upon the future taxpayer is compensated by the benefit then accruing to the bondholder. There is indeed a burden upon the future taxpayer, but not of the kind imagined. Public debts of large amounts are never paid in the manner supposed. When a public debt falls due, it is not paid out of the proceeds of taxes levied upon the taxpayers of that particular year. If the debt is not refunded, but actually paid off, it will be extinguished by utilizing the funds which have been accumulated for a term of years. If there is a sinking fund, the burden upon the future will be represented by the annual amortization quota. In such a case the burden will be borne not by the taxpayers at the time when the bond falls due, but in instalments by the successive annual taxpayers, beginning with the year when the bond was first issued. The same is true if the bonds are serial bonds the instalments of which fall due periodically. In this case, only the burden representing the last instalment will be borne by the taxpayers at the expiration of the loan. If we take the sinking-fund bond as a type it may be said that the benefit accruing to the bondholder is represented by the accumulated interest and that the burden resting upon the taxpayers is composed of the entire debt service, that is the interest charge together with the amortization quota, since the interest charge figures on both sides of the ledger as benefit and as burden. The amortization quota is the net burden resting upon the successive contingents of taxpayers until the sinking fund is completed or the debt is entirely paid off. That this net burden upon the future may be outweighed—and, in general more than outweighed—by the net benefit accruing to the present has been indicated above.

We may, therefore, consider it as established that it is possible, not only to diminish the subjective sacrifice on the present,

loan to transfer a part of the burden to the future, there is little difference between us. For Professor Pigou agrees (pp. 650–1) that there are at least three separate ways in which the national dividend of the future may be injuriously affected.

But on the general question as to whether these burdens on the future are compensated by the advantages to the present, Professor Pigou is curiously non-committal, either not alluding to some of the arguments mentioned above, or weighing others so dispassionately in the balance that no definite conclusion is reached. As a general discussion of the subject of taxation *vs.* loans his treatment can therefore not be pronounced particularly successful.

but also to put a share of the burden upon the future. It has also been established that the device of public credit necessarily accomplishes the second result in effecting the first. The problem at issue is the cost of making final settlement of the war bills of the government. This settlement must be made by taxpayers and it can be postponed. If the government borrows, it obtains money from people who get a good investment and who are making a very slight sacrifice. The sacrifice on the part of a purchaser, rich or poor, of a Liberty Bond is much less than the sacrifice of a taxpayer who gives up his money without return. The sacrifice of the taxpayers who must pay the bills can be postponed and this postponement may involve the undoubted advantage of spreading large payments over a period of years.[1] Public credit, if correctly employed, may, in shifting a part of the subjective sacrifice to the future, lessen the total real costs of a war to the community as a whole, viewed as a continuing entity.

III. *Ought the Burdens of a War be Shared with the Future?*

Although it is possible, as we have just seen, to shift a part of the burden from the present to the future, the next problem is as to when, if ever, this is justifiable. The point at issue here, be it observed, is not as to the relative advantages of loans *versus* taxes, but as to the classes of cases when loans are to be permitted as a matter of principle. In order to solve this problem we need a more detailed analysis of public expenditures.

For our purposes all public expenditures may be divided into two classes: current and capital expenditures. Current expenditures are those incurred for carrying on the ordinary business of government while maintaining its property or plant at the customary level. Capital expenditures are those incurred for increasing the property or plant of the community.

Capital expenditures may again be divided into expenditures

[1] Mr. Hartley Withers, who originally held this view, has been so influenced by the rather hasty pronouncement of some American writers that he has recanted. *Cf.* his *Our Money and the State*, 1907, p. 29. But even he balks at the proposition that public borrowing is always unjustifiable, and accepts it as defensible when employed for productive purposes (*Ibid.*, p. 43). Had he pushed his analysis a little further he would have realized the fact that no distinction can be drawn between consumption and production credit, and that the economic utility of credit may attach equally to both forms.

for self-supporting and for non-self-supporting purposes. Expenditures of the first kind are seen in the case of water-works where the revenues are expected to defray more than the cost. Here it is entirely legitimate to issue bonds, because although the burden upon the present is diminished, there will be no burden upon the future. By the time the bonds expire, a sinking fund will have been accumulated out of the revenues which will also in the interval have provided for the payment of the annual interest. It is for this reason that in the city of New York, for instance, not only the water and dock bonds, but those issued for any municipal improvement the revenue from which will defray the interest together with an amortization quota, are by law excluded from being counted in the debt subject to constitutional limitations as to size. If such improvements had to be paid for out of taxes they would frequently not be made at all.

Many capital expenditures are, however, incurred for non-self-supporting purposes. The funds, in other words, are spent for additions to the community plant or property from which no, or only little, money revenue is expected. The dividends are, in whole, or in part, of a non-material kind. Such expenditures may be further subdivided according as they are recurring or non-recurring. An example of the first kind is a schoolhouse. A schoolhouse represents an addition to the capital or permanent property of the community. Under the American system it is not used for purposes of revenue, as no fees are charged. In a growing city where population is continually increasing it is obvious that more schoolhouses will have to be built every few years and perhaps even annually. Since, therefore, the same capital expenditure will have to be made every year, or almost every year, it is proper that it should be paid for every year, or almost every year. In other words, the cost of schoolhouses in a constantly growing community ought to be defrayed out of taxes on the pay-as-you-go principle. The situation is, however, different with the other class of non-self-supporting capital expenditures, namely, those of a non-recurring kind. Take, for instance, the purchase by the government of the telegraph or telephone system with the intention of so reducing charges as not even to meet running costs. Or, better still, take the building of a great art museum in a city or the purchase of a comprehensive system of parks. In the ordinary course of events a considerable period would

elapse before another art museum or another such system of parks will be needed. Since the museum or park will continue to benefit the community as a whole for many years, there is evidently an impropriety in putting the entire burden upon the taxpayers in any one year. To attempt to do this would not only be inequitable in itself, but would also defeat its purposes; for the larger the expenditure, the more disinclined would the taxpayers of any one year be to authorize the outlay. The probable result would be delay, or even complete failure, to authorize much-needed improvements. In the case, therefore, of non-recurring, non-self-supporting capital expenditures the utilization of public credit is clearly permissible.

There is of course a border line or twilight zone where the arguments as between loans and taxes are rather evenly balanced. Take the New York court-house problem as an example. It is difficult to say whether this ought to be called a recurring or a non-recurring expenditure. A new court house is indeed not needed every year. It is only a few decades, however, since the present court house was rebuilt. The same is true of bridges in a rapidly growing community. More than a certain number of bridges will probably not be required for a long time. But in the interval, new or better bridges may be needed every few years. Where the opposing arguments are so close, it is evidently wise to defray the outlay partly out of loans and partly out of taxes.

Opposed to the capital expenditures of government are the current expenditures. These may be divided into ordinary and extraordinary expenditures. Ordinary expenditures are those which are incurred for the ordinary work of government from year to year as it may be anticipated and arranged for in the budget. As to these, there is no question but that they should be met entirely out of the proceeds of taxes. One of the glaring abuses of the old Tammany régime in New York City was the way in which it kept the tax rate down by borrowing money for the ordinary current expenditures; as, for instance, the issue of twenty-year bonds for the purchase of brooms which lasted only a few months.

Extraordinary expenditures, on the other hand, are those which cannot well be foreseen or predicted with any reasonable accuracy; as the result of some unforeseen contingency they are out of the regular order, that is, they are extraordinary.

Extraordinary current expenditures may, however, like the

capital expenditures mentioned above, be subdivided into recurring and non-recurring expenditures. A non-recurring extraordinary expenditure is typified in the case of the Chicago or the Boston fire. Since the outlay needed to keep these communities alive, or to repair the ravages of the conflagration, may not be expected ever to occur again, or certainly not for a long future, it would be manifestly improper to saddle the entire burden upon the unfortunate taxpayers of that particular year. The probability is that if any attempt were made to do so the needed repairs could not be made at all, or certainly not to the extent that would be appropriate. Of a similar character would be the extraordinary expenditures occasioned by a great flood or famine in a country unaccustomed to such catastrophes.

On the other hand, there are certain classes of extraordinary expenditures the recurrence of which may be reasonably expected, although the date of the recurrence is unknown. This would be the case with earthquakes in a country like Italy, or famines in a country like India, or tornadoes in some parts of the United States. In such cases it is entirely proper to accumulate out of the proceeds of taxation a fund which can ultimately be used for that purpose when the occasion arises. Since the contingency may occur at more or less periodic intervals it would manifestly be unwise to shift the burden upon the future; for before the future comes, another contingency of the same kind may have occurred.

When finally we come to such expenditures as these of modern wars, the question of exact classification is attended with considerable difficulty. It is indeed true, that as long as human nature remains what it is and the fundamental causes of an economic and racial character are not removed, every nation must look forward to periodic outbreaks of this scourge. Certainly there is nothing to predispose us to the belief that the history of the world was so totally changed in the year 1918. In a certain sense, therefore, the extraordinary expenditures of a war may be put in the class of recurring expenditures. The recurrence, however, of such a gigantic war as the late world conflagration cannot be regarded as immediate. It is to be expected that it will take at least several decades for the various belligerents to recover from the strain and stress of the conflict. In the meantime, whether it be one decade or several decades that elapse, the benefits, such as they are, in any particular country necessarily attach to the intervening years.

And at all events, it is not legitimate, even if there are no benefits at all, to put the entire burden upon those who happen to be taxpayers during the course of the war. When we speak of the distinction between the present and the future, it is not necessary to conceive of the future as the future generation or the future century. There are all manner of changes in the taxpaying abilities of the citizens within a century or even within a generation. And with reference to the particular circumstances of the recent conflict, if it was a war to make democracy safe, it is certainly just that the coming decades which will enjoy the benefits of security should bear some part of the cost of preserving it.

The conclusion, therefore, would be that in the case of a great war it would meet all the demands of justice to put part of the burden upon the present taxpayers and to shift the remainder upon the taxpayers of succeeding years, with the understanding that all the charges of the war will finally have been met before the period when the recurrence of a similar outbreak is within the realm of probability. This conclusion in other words shows the essential legitimacy of utilizing both loans and taxes in times of war.

IV. *The Disadvantages of Loans*

The net gain involved in public credit may be impaired or even converted into a loss in three ways: (1) if exclusive use is made of public credit; (2) if the system of taxation after the war is materially changed to the disadvantage of the community; (3) if public credit is so abused as to lead to serious inflation. Let us consider each of these in turn:

1. All credit rests on a substratum of cash. Private credit is an adjunct of capital, but it must depend on capital. The loans that a bank can make ought never to exceed a certain percentage of the reserves. The volume of credit can always be greater than the amount of the cash reserve; but it cannot safely be independent of that amount. In the same way the attempt to finance a gigantic war entirely by loans without any solid basis of taxation would also represent unsound finance. The resulting loss of confidence would manifest itself in a depreciation of successive issues of government bonds and would ultimately cause embarrassment or disaster. But just as a bank may issue several dollars of credit for one dollar of cash, so a

government may borrow for war purposes considerably more than it raises by taxation with equal advantage to all concerned. To finance a war entirely by loans is inadvisable; to finance a war in large measure by loans is legitimate. Employed in moderation and based on a solid foundation of largely increased war taxation, war loans are advantageous in reducing war costs. But the foundation of taxation must support the edifice of loans. Unless taxes are levied to an amount at least necessary to provide for the interest on the new loan, as well as for a reasonable amortization quota or additional sums calculated to sink the debt within a reasonable period, the advantages of war loans will disappear. This is the serious danger to which some of the belligerents, like France, Russia and Germany, succumbed in the recent conflict.

2. If taxes during the war were to be raised entirely from those best able to pay, and if the tax system were to be so altered after the war as to bear with severity upon those less able to pay, the advantage of loans over taxes would be impaired. It might be claimed, for instance, that the ordinary system of taxation in peace times is influenced so largely by the richer classes that wealth escapes its share. As a result of a war, however, the wealthier classes will become more patriotic and will be more ready to contribute. Even if this should not be the case, the very immensity of the sums to be raised, it might be said, will make it impossible to secure what is needed from taxes on general consumption and will necessitate resort to taxes on wealth. To raise any part of war expenditures, therefore, by loans instead of by taxes simply means that the less affluent classes will ultimately have to pay more. This involves a serious social maladjustment.

It may be questioned, however, whether such an argument is not in reality illicit. For we have here a comparison not between loans and taxes but between two different systems of taxation.[1] It is conceded that if taxation after the war could be based upon the same general principles as taxation during

[1] Professor Pigou, with whom this argument originated, does not compare taxes in general with loans in general, but taxes on the wealthy with taxes on the poor. "Under the tax method the rich and moderately rich really shoulder the whole burden of the charge that is laid upon them. Under the loan method they do not do this, because they are compensated afterwards through taxes laid for that purpose, partly on themselves, but partly on other and poorer sections of the community." *The Economy and Finance of the War*, 1916, p. 70.

the war, the entire argument would fall away.[1] But this, we are told, is exceedingly unlikely. The enthusiasm engendered by the war, which will make the wealthy willing to pay greater taxes, will subside after the war.[2]

The retort, however, at once presents itself: what if peace taxes should be better than war taxes? It might plausibly be argued that during the enthusiasm engendered by a war the great mass of the people, and not only the very rich, might be willing to endure extra burdens; whereas after the return of peace they would insist upon a more equitable distribution of the burden. As a matter of fact the fiscal history of our own Civil War would tend to bear out this theory. The tax system during the Civil War was composed to an overwhelming extent of burdensome taxes on the great mass of the community. The income tax, for instance, was slight as compared with the tax on manufactured articles. After the return of peace, on the other hand, these burdensome taxes were removed one by one and the income tax was among the very last to disappear. Instead of the tax system after the war becoming progressively worse or more unjust, it became progressively better, or less unjust. The same thing is true of the fiscal history of other wars.

In truth, however, such an interpretation would be just as invalid as the preceding one. There is no necessary or probable tendency in the one direction or in the other. Some systems of war taxation have been better, and some have been worse, than corresponding systems of peace taxation. There is nothing in the nature of war or peace which will fundamentally affect the situation. No one class in the community has a monopoly of loyalty. History does not show that either the rich or the poor are more patriotic. The real forces which make for more equitable taxation are the growing democratization of the community with an increasing realization of the principles of

[1] Professor Durand tells us "if we could assure ourselves that the distribution of taxes after the war would be as the distribution of taxes during the war, there would be little choice between taxation and borrowing." *Financial Mobilization for War*, papers presented at the Joint Conference of the Western Economic Society and the City Club of Chicago, June 21 and 22, 1917, p. 18.

[2] Professor Durand bases his whole argument on the assumption that the post-war taxes would be less equitable than the war taxes. He concedes that "this is not a necessary result," but he believes that "the great political power of the well-to-do classes would almost certainly enable them, if they sought to do so, to shift part of the burden on the poorer classes, and they would probably seek to do so." *Op. cit.*, p. 26.

justice. Modern systems of taxation, in war as in peace, are everywhere more equitable than former systems because of the gradual prevalence of these two factors. There is no warrant for the assumption that the return of peace will check this progress of democratization. There is no adequate foundation for the belief that in a democracy the fundamental causes which make for justice in taxation will be less strong in peace than in war. A faulty analysis of the history of taxation and of democratic progress is not a sufficiently firm basis on which to predicate the inferiority of loans.

3. The third disadvantage of loans is alleged to be the tendency to inflation. As to the dangers and shortcomings of inflation, the burdens of which are borne in large part by the less affluent classes, it is unnecessary to speak. That loans may lead to inflation is undoubted; that loans necessarily lead to more inflation than would be brought about by other methods of securing revenue, is quite another matter.

To what extent can it be said that loans lead to inflation? In the case of foreign loans the question can of course not arise so far as the home country is concerned. Domestic loans, however, may be derived from five sources:

(a) From the liquid or free loanable capital in existence. Large sums, the results of previous accumulation, are always found ready for investment in the financial centers. In the United States these are to a great extent loaned on the stock exchange and used for purposes of speculation. The transfer of these funds from the stock exchange to the government will assuredly not lead to inflation. Rather, the contrary would be the case.

(b) From the surplus of current production. The annual surplus products of a community are ordinarily converted into productive capital through new investment. If these investments are turned into the channel of government bonds instead of industrials, there is no tendency to inflation.

(c) From a change of investment. If investors are tempted to sell their foreign securities and to buy governments bonds, there is again no tendency to inflation. If they sell their domestic industrial securities in order to invest in government bonds, there will even be a tendency to the contrary. For the throwing of so many domestic securities on the market will be likely to reduce their value—leading to lower, rather than higher, prices.

(d) From anticipated savings. Many a citizen of moderate means will invest in war bonds, paying for them by the fractional certificates which he laboriously purchases out of the savings due to decreased consumption or increased production. This will lead not to inflation, but to the reverse.

(e) From borrowing at the bank. It is only in this case when the investor pays for his war bonds by borrowing from the bank, or when the bank itself subscribes to the war loans, that the undue extension of credit by the bank may lead to inflation. This is in fact the most common way, apart from the issue of paper money, in which inflation occurs.

What we are considering, however, is primarily not whether loans may cause inflation, but whether inflation is necessarily the consequence of loans or whether there is anything peculiarly distinctive about loans in causing inflation. These considerations have almost entirely been overlooked in the discussion.

In the first place, there is no doubt that wars are always attended by inflation. But this inflation would ensue entirely apart from loans. The chief factors which explain the rise of prices during a war are the vastly augmented demands of the government, the dislocation of production coupled with the falling off in the social output, and the augmented supply of the currency. These are the fundamental causes which make for inflation and they will exert their effect irrespective of the choice between loans and taxes.[1]

In the second place, it is a fallacy to suppose that if loans lead to inflation taxes will prevent inflation. Modern war taxes are to an overwhelming extent levied on business. The distinguishing features of our recent system, for instance, were the high corporate income and excess-profits taxes. It is familiar to those acquainted with business conditions that many corporations whose profits were largely on paper, whose resources were heavily engaged, and who were anxious to utilize their profits in extending their operations, were even in the early stages of the war preparing to borrow on a large scale from the banks

[1] *Cf.* the recent weighty utterance of former Assistant Secretary of the Treasury, R. C. Leffingwell, "The world had been living beyond its income living to some extent upon its accumulation of wealth. This would have meant inflation even if the whole cost of the war had been met from current taxes, for the money to pay taxes could only have been had by expanding credit to the extent that war expenditures exceeded the net income of the people." *Introduction* to E. L. Bogart, *War Costs and Their Financing*, New York, 1921, p. xvii.

or to issue short-time notes in order to pay their taxes. Were a war financed entirely, or to a large extent, by taxes instead of by loans, this resort to bank credit on the part of prudently managed enterprises would be still further emphasized. There is consequently less difference than is commonly supposed between a resort to loans and a resort to taxes. Some of the funds are almost inevitably borrowed from the banks in each case; and it is by no means certain that the borrowing is likely to be far more marked in the case of great loans than in the case of very high taxation.[1]

Finally it must not be forgotten that if there were no loans, or even insignificant loans, the tax system would, in all probability, not only be excessive in its burdensomeness, but, as we shall see, inadequate in its yield. With a failure of war taxation to defray expenditures the ultimate resort would then necessarily be to fiat money or inconvertible paper which, as everyone concedes, causes far greater inflation than anything else. Thus the failure to resort to loans in proper amount would almost inevitably, in a protracted contest, lead to the worst possible kind of inflation.

Is it not clear then that the relation between loans and inflation must not be exaggerated? Loans may indeed lead to inflation, but so may taxes lead to inflation; inflation is due primarily to other and more fundamental causes than either loans or taxes; and the attempt to avoid inflation by abandoning the use of loans will almost inevitably lead to far greater inflation in the end.

If, then, there is little reason for anticipating (1) any serious abuse of public credit, or (2) a fundamental and unfortunate change in the tax system after the war, or (3) any undue or peculiar tendency to inflation as a result of loans, it follows that a proper use of public credit may be of net advantage to society.

V. *The Comparative Merits of Taxes*

Up to this point we have adverted to the advantages and disadvantages of loans and by implication have considered

[1] It is significant that Professor Pigou, who was the first to put forward the inflation theory in war finance is careful not to limit this eventuality to loans. "If, as is probable in the case of very large levies, their (the rich) borrowings for war loans and war taxes exceed their normal borrowings in times of peace, there is likely to occur a certain amount of currency inflation." *The Economy and Finance of the War*, 1916, p. 76.

some of the advantages and disadvantages of taxation. It may conduce, however, to clarity of exposition to marshal here some of the arguments which refer particularly to taxes.

The first advantage of war taxation is its effect upon consumption. As we pointed out at the beginning, the important point in the economic life of a community at war, as in peace, is to have a surplus of current production. This surplus must be measured in terms not simply of material output, but also of subjective sacrifices. The outstanding fact in every great war is the sudden and sharp reduction in production. Unless the consumption of the community keeps this slower pace the result will be disastrous. For although the community can rely to a certain extent upon the accumulations of the past and can also, as we have pointed out, defer some of the sacrifice to the future, a large part of the burden must be borne at present. The current consumption of the community must be cut down to the measure of the current production if there is to be any surplus.

The advantage of high war taxes is that they may help to bring about this result. But while this is true, the effects of taxation on consumption must not be exaggerated. In the first place taxation is not alone in affecting consumption. Consumption may be influenced by legislative prohibition and by rationing. In truth, during the recent war, these factors were of much greater influence than taxation. In the second place taxes are not the only fiscal expedient which can affect consumption. Among the chief points in the recent issues of war loans, here as abroad, have been the appeal to patriotism and the facilities afforded for investment in the loans, to be made good by current savings. It is true that taxes involve a compulsory, and loans only a voluntary, appeal to saving. But it would be a mistake to overestimate the influence of the former and to underestimate that of the latter in reducing consumption.

In the third place the beneficial effects of taxes upon consumption may be seriously exaggerated. If, as is true, war taxes largely assume the form of taxes on business enterprises and corporations, there will be almost no influence upon consumption, and the little influence exerted on consumption may be outweighed by the possible injurious effects on production, thus reducing instead of enlarging the social surplus. Moreover, even as far as individual income taxes are concerned, the

results are by no means certain. On large and very large incomes the tax is not apt to be paid out of current income at all. The ordinary man of wealth will be much more likely to draw temporarily upon his capital during the war than to reduce his personal expenditures. Again, while it is true that very high taxes on small or moderate incomes will check consumption, the danger is that we shall cause not only sacrifices, but real privation, the disadvantages of which may counterbalance the advantages of a reduced consumption.

While, therefore, high war taxes may tend in part to reduce consumption, the effects and beneficial consequences can easily be exaggerated.

The second advantage of high war taxes is that the actual burden in times of war is really less than it appears to be. A war gives unusual opportunities to make immense gains and the profits secured by the war contracts are apt to be more or less widely diffused throughout the community in the form of high wages and general business prosperity. It is for this reason that the tax on war profits, or on excess profits, has everywhere become a fundamental feature in the tax program. In the second place, the higher price level due to the inflation that always accompanies a war makes a given tax a much smaller relative burden. Thirdly, it is more economical to levy high taxes during a war when the diversion of current income to ordinary investment of capital is relatively small than to postpone the tax until a time when the need of capital investment again becomes acute.

These are the undoubted advantages of high taxes. But over against the advantages must be set the disadvantages.

The first drawback is the inadequacy of taxation during a war. The protagonists of high taxation seem to think that the entire, or well-nigh the entire, expenditures of a war may be met from taxation.[1]

Even a superficial glance at the facts ought to show the baselessness of such an assumption. We do not venture to utilize here any figures as to national wealth or social income, because of the worthlessness for scientific purposes of any such com-

[1] So, for instance, Professor Durand says: "If during the war itself highly progressive taxes were levied sufficient to meet the war expenditures," *op. cit.*, p. 26. The same thing is true of Professor Sprague and some other American writers. Professor Pigou, however, is much more cautious in advocating only increased revenue from high taxation.

putations. But we should like to emphasize the fact that the limit of taxation is to be measured not by the social income, but by the social surplus, that is, the excess of the net income over the consumption of the members of society. This social surplus is very much less than is often represented. In England, for instance, where the tax on moderate incomes was soon raised to 25 per cent and on the larger incomes to 42½ per cent, the net additional receipts from the income tax amounted to about one billion dollars. Even if we assume that the recipients of moderate incomes could endure the privation of an additional 25 per cent of the income, thus doubling the returns; and if we further assume that on the higher grades it would have been possible to confiscate the entire income beyond a small minimum, thus doubling or trebling the revenue, we should have as the conceivable maximum from the income tax in Great Britain between three and four billions of dollars. Again, if the excess-profits tax had been increased from the eighty per cent, which yielded about one billion dollars, so as to take in all of the profits, we would have another few hundred millions income. If, therefore, England had taxed the entire available social surplus through the highest possible income tax and excess-profits tax, the total revenue would have been absurdly short of meeting the war expenditures. In order to meet even one-half of the war expenditures from taxation it would have been necessary for Great Britain, in addition to confiscating incomes and profits, to impose immense burdens upon that part of accumulated wealth or property which is susceptible of sale abroad.

The figures *mutatis mutandis* would be similar in this country. In order to raise even one-half, not to speak of the total, of the nineteen billions that were asked for in 1918 and of the still larger sums which would be needed as the war progressed, it would have been necessary not only to take by taxation most of the smaller incomes and all of the higher incomes, but also to confiscate virtually all of business profits, and finally, after levying crushing taxes on consumption, to take such part of the existing private property of the United States as could find a ready market abroad. Even the mere statement of such a proposition carries its refutation on the face.

But if the inadequacy of sole reliance upon taxation is patent there are also well-founded objections to levying excessive taxes even short of this impossible total. Taxes may roughly

be divided into taxes on wealth (income, property and inheritance taxes), taxes on business (taxes on profits, production and exchange), and taxes on consumption (import duties and excises).

The chief modern tax on wealth is the income tax. It is accordingly entirely proper that in time of war the principal reliance should be based on this source of revenue with a very much higher graduated scale of progression on the larger incomes. But entirely apart from the extreme, advocated by some, of confiscating all incomes over $100,000 [1] there are at least four dangers in excessive income taxes.

1. The administrative difficulties will be greatly increased. It is as true of the income tax as of the arithmetic of the customs that two and two do not always make four. Excessive import duties induce smuggling; excessive income taxes engender evasion. With such a delicately adjusted machinery as in the case of our income tax it is to be feared that excessively high rates will cause not only a disappointing yield but also an increasing inequality as between individual taxpayers.

2. If the rates are too high, the tax may act like an excessive consumption tax and, by pressing unduly upon the margin of comfortable existence, cause great privation.

3. If levied chiefly upon the higher incomes, it may seriously trench upon the sum ordinarily devoted to the educational, philanthropic and religious institutions and thus cause widespread injury to the immaterial interests of the community. This objection has only in part been removed by the recent amendment to our income tax law.

4. Excessive taxes on incomes will deplete the surplus available for investment and interfere with the placing of the enormous loans which will be necessary in any event. It might be replied to this last argument that the more is raised by taxes the less will have to be raised by loans. This does not, however, meet the point. For if the taxes are so high as to discourage industry they will obviously dry up the source of future incomes and thus deplete to that extent the surplus which would otherwise be available for future loans. Entirely apart from that fact, however, high taxes will interfere with loans in so

[1] This has been done by Professor Sprague in his address before the American Economic Association. *Papers and Proceedings of the Twenty-ninth Annual Meeting of the American Economic Association, December, 1916*, p. 211. Similar propositions were made in Congress.

far as the loans are financed even temporarily by the banks. If a would-be investor borrows from a bank, the amount of his credit will be in a certain proportion to his estimated profits. Every dollar's d'minution of his prospective income will cause several dollars' decrease in the amount which he will think it prudent to borrow or which the bank will think it safe to lend. If, therefore, the income tax is so high as seriously to deplete his investing surplus, it will cause a far greater falling off in the amount which he can subscribe to the loan. It is significant that this is the chief argument that weighed with the Chancellor of the Exchequer in England in refusing to increase English taxation.[1]

Excessive taxes on business again may have all manner of injurious consequences. Taxes on war profits are indeed not open to the same objections, but our tax on excess profits is far more than a tax on war profits. When they are too high, they tend to check the needed transfer of industry and of investment to war purposes just at the time when new enterprise is desperately needed. Although our tax could by no means be called excessive, it is well known that in several important cases it did exert such a repressive effect.

The evils of excessive taxes on exchange and consumption are so familiar that they need not be recounted here.

It will be seen, therefore, that the dangers of excessive taxes are not to be overlooked. The anti-social consequences of excessive taxation are perhaps more to be emphasized than the similar evils of excessive loans.[2]

[1] Mr. Bonar Law stated this on several occasions, the last time on August 13, 1917: "I quite admit that in financing the war the government has to get the largest amount out of taxation which is compatible with maintaining the financial security of the country; but I have said many times that there comes a limit at which if you keep on increasing taxation, you might give up all hope of raising money by loan. It is obvious that if you tax to such an extent as to destroy the financial position, you must abandon all hope of loans." *Parliamentary Debates*, vol. xcvii., p. 944, 945.

[2] This point has recently been emphasized by ex-secretary Leffingwell, in discussing the proposal to defray all the war costs out of taxes. "It Congress had passed such a tax law, it is not difficult to guess that the consequence would have been a business catastrophe which would have put us effectively out of the war . . . one thing is clear, that if excessive taxes were imposed, the fact might not be known until efficiency was impaired and the harm done. In war time it would be impossible to repair the injury done by a tax levy which in fact was excessive." *Introduction* to E. L. Bogart, *War Costs and Their Financing*, 1921, p. xix.

It is important, moreover, that the public mind should be informed not only as to the dangers of excessive taxation, but also as to the inevitable failure of exclusive reliance upon any single group of taxes. It would have been in the highest degree unfortunate if through emphasis upon such slogans as "conscription of wealth" and the like, the general citizen body had acquired the feeling that war taxation meant immunity for themselves. Just as a war from a military point of view can be won only by putting forth the united efforts of the nation, so a war can be won from the fiscal point of view only by reliance upon the ability of the entire citizen body, whether rich or poor.

VI. *Conclusions*

The conclusions from the above analysis are as follows:

1. Government loans are indispensable to a sound war finance. If properly used, they tend to lighten the burden of a war.
2. To attempt to finance a war exclusively through loans is short-sighted.
3. To attempt to finance a war exclusively through taxes is suicidal.
4. War taxes should be large and immediate, but should never be stretched beyond the point where they begin to lessen the social output, to hamper the transfer of pre-war to war production, or to press unduly on desirable consumption.
5. War taxes must be high enough to assure a solid foundation for the loans and to ensure a rapid payment of the debt within a relatively short time.
6. At the outbreak of a war, and during the early period, very much greater sums ought to be raised by loans than by taxes.
7. As the war proceeds a continuously larger amount can and should be raised by taxation, although at no time will the government be free from the necessity of relying to a considerable extent upon the use of public credit.

CHAPTER XXIV

THE COST OF THE WAR AND HOW IT WAS MET [1]

The time has not yet come for a final statement of the fiscal history of the war. For one thing, the figures are not yet completely available; and, in the next place, the expenses connected with the war are not yet over. It is, however, not premature, one year after the declaration of the armistice, to attempt to present in a summary fashion a preliminary survey and interpretation of the facts. Various *ad interim* endeavors to present certain phases of the subject have already been made.[2]

[1] This chapter is reprinted, with a few changes, from the article in *The American Economic Review*, vol. xix (1919).

[2] The presentation of facts for the earlier period of the war will be found in the bulletins of the Copenhagen War Study Society and of the *Société de Banque Suisse*. Some later figures will be found in L. P. Ayres, *The War with Germany*, published by the Statistics Branch of the General Staff of Washington, 1919. Some computations as to the cost of the war will be found in Edgar Crammond's *Address on the Cost of the War* before the Institute of Bankers, London, March, 1919; as well as in Sir Edward Holden's *The Cost of the War and its Payment* in his report to the London City and Midland Bank, January, 1919. Facts as to public debts will be found in *The World's War Debt* (Mechanics and Metals National Bank, New York, 1919); in *The Internal War Loans of Belligerent Countries* (National City Company, 1918) The most painstaking collection of facts has been compiled by one of my former students L. R. Gottlieb and published with variations in three separate places. The first was an article on "The Indebtedness of the Principal Belligerents" in the *Quarterly Journal of Economics*, May, 1919. The second was the booklet entitled *Financial Status of Belligerents*, published by the Bankers Trust Company, New York, 1920, with an introduction by myself. The third was entitled *Post-War Finance*, and *International Finance in its Post-War Aspects*, published by the Bankers Statistics Corporation, New York, in their *Weekly Service*, vols. ii and iii, 1920-21. *Cf.* also E. L. Bogart, *War Costs and Their Financing. A Study of the Financing of the War and the After-War Problems of Debt and Taxation*, New York, 1921. The most valuable document for the earlier period of the war is the report, No. 4133, to the French Chamber of Deputies, by M. Louis Marin in 1917. By all odds the most complete and valuable studies on the subject are those by Professor Gaston Jèze in the *Revue de Science et de Législation Financières*, vols. xiv.-xviii. He has dealt particularly with England, France, Italy,

The problems to which it is desired here to call attention are as follows. First, what is meant by the cost of war? Secondly, in considering actual governmental outlays, is it desirable to distinguish between the expenditures during the war and war expenditures? And, if the answer be in the affirmative, how are the latter facts to be ascertained? Third, from what sources were the actual war outlays derived? This introduces the question of taxes *versus* loans. The facts as to taxation are first to be secured. Here it will be seen that there is considerable confusion as to what is meant by war taxes, and that, just as there has been a failure to distinguish between expenditures of the war period and war expenditures, so the proper line has not been drawn between taxation during the war and war taxation. A correct interpretation of the facts will yield some rather unexpected results. The fourth problem is that of the relative weight attached by different countries to the various categories of taxation in raising the necessary revenues. Finally, we have to consider the rôle played by public debts and the relative importance attached to long-time and short-period borrowings.

In order to put the results in the most compact form, a series of tables have been constructed. The figures throughout this have been taken from official sources; [2] and the foreign curren-

and Germany in three series of articles entitled respectively "Les Finances de Guerre," "Les Méthodes Financières," et "Les Emprunts de Guerre." Most of these studies were reproduced in the three volumes entitled *Les finances de guerre de l'Angleterre*, 1919; *Les Finances de guerre de la France*, 1920; *and Les finance de guerre de l'Italie*, 1920.

[1] The official sources that have been utilized are as follows:

Great Britain: The various speeches, as found in Hansard, of the chancellors of the exchequer (Lloyd George, 1914–15; McKenna, 1915–1916; Bonar Law, 1917–1918; and Austen Chamberlain, 1919,—the last being his speeches of May and June, 1919) and of the Prime Ministers (Asquith and Lloyd George); the *Annual Finance Accounts;* the *Reports of H. M. Inland Revenue;* and the *Return relating to the National Debt from 1875 on* (cd. 8972, 1918).

France: The annual reports (*Rapports généraux*) of the Budget Commission; the *Exposé des motifs du projet de loi* for each of the new revenue laws; and the speeches in the Chamber of Deputies of the Ministers of Finance (Ribot, 1915-16; Klotz, 1917–19,—the last being the speech of May 27, 1919).

Italy: The reports (*Relazioni*) and speeches of the Ministers of the Treasury (Carcano, 1916–17; Nitti, 1917–18; Stringher, 1919; Schanzer, 1919, —the last being the speech of July, 1919) as well as the studies of Professors Flora, Cabiati and Einaudi.

Germany: The Reichstag speeches of the Ministers of Finance (Kuhn,

cies have been converted into dollars according to a scale which represents their actual pre-war coin value.[1] Owing to the depreciation of the foreign currencies, this naturally gives a somewhat exaggerated picture of the existing burdens.

I. *The Expenditures*

The cost of the war may mean several different things. In the narrower sense, it means the actual money outlay, or expenditure in dollars and cents, directly involved in prosecuting the war. In the wider sense it includes many items, both direct and indirect, which are of significance from the economic point of view. The real cost of the war in this sense may mean either the actual loss of lives and of property or the diminution of the annual social output. The direct loss of property is susceptible of fairly accurate measure; the cost due to the loss of lives is more difficult to estimate. Most of the calculations on the latter point have been entirely arbitrary. So far as the wealth of a country is measured by its social income it may be reduced by the actual loss of territory, as in Germany and Austria; by the impairment of its natural resources such as coal mines and forests, as in France; by the reduction of labor power, due to the wounded workmen or the results of starvation on the civilian population, as in most of the European countries; or by the loss of economic efficiency due to a lowering of the standard of life or to a change in the attitude toward habits of work. The total costs of a war in this sense, although they are for the most part incalculable, are none the less of profound significance.

In this chapter we shall attempt to deal only with the direct money costs. These direct money costs or governmental expenditures for war include not only the actual outlays for

1914–15; Helfferich, 1915–16; von Roedern, 1916–18; Schiffer, 1918–19; and Erzberger, 1919,—the last being his speech of October, 1919).

Russia: The reports of the Ministers of Finance, especially Bark, 1914–16; Gukovski, 1916–17; and Tereschenko, 1917.

Austria-Hungary: The reports of the Budget Commissions.

Translation of some of these reports will be found in the *Bulletin de Statistique, The Economist* and *L'Économiste Européen.*

[1] 1 £ = $4.87. 1 ruble = 51.5 cents.
1 franc = 19.3 cents. 1 crown = 20.3 cents.
1 mark = 23.8 cents. 1 £T = $4.40.

military and naval purposes but also the whole range of expenditures incurred in industrial life to prepare the wherewithal for the army and navy; and they also comprise the sums devoted to the maintenance of the families of the soldiers. All these items are far greater in modern times than they used to be. It is a far cry from the meeting of two savage tribes armed with bows and arrows or javelins to the modern sixteen-inch guns, the dreadnoughts, the aeroplanes, the submarines, the poison gas, and the innumerable technical adjuncts of modern warfare. The consequence is that the money costs of the Great War far transcended those of all previous conflicts.

The attempt to present in figures the cost of the war even in this restricted sense meets with several difficulties. In the first place, the question arises as to the period when we ought to stop. In one sense the war ceased when the armistice was declared: in another sense the war did not actually stop until peace was ratified. But even when peace was made, the war expenditures were by no means over. The process of demobilization was a slow one and in many countries there have been considerable demobilization bonuses. Moreover, it was necessary to continue for some time the policing of the conquered countries. Again, we must take account of the compensation to citizens for war damages; of the expenses of reconstruction; and of the loss on exchange of the depreciated currencies. Finally comes the question of the pensions to the wounded soldiers or to the families of the dead. It will be seen, therefore, how impossible it is to state with any accuracy at the present time the costs of the war, while these are still being incurred. The best plan has seemed to include in the war costs the period of from six months to a year (according to the dates of the expiration of the various budgets) after the final cessation of hostilities, *i. e.*, from March to October, 1919. But this of course renders the figures only approximate. Furthermore, the figures ordinarily given contain many inaccuracies. The richer countries made advances to the poorer countries, and these expenditures are sometimes counted twice in the total—a procedure legitimate only on the assumption that the loans will not be repaid. Again, in a country like the United States, which has substituted an insurance system for pensions, the nominal expenditures appear smaller than is really the case, because of the receipt of vast insurance premiums which will ultimately all be expended again. Finally, the figures make no

allowance for the changes in the price level or the alteration in the value of money. In a great war like the one just finished, prices always rise; in some countries they have doubled, in some they have more than trebled, for reasons which it is needless to discuss here. What seems, therefore, to be an increasing outlay from year to year may be in reality due, in part at least, to this cause.

After making allowance for these difficulties, we may proceed to state some of the facts as to the actual outlays of various countries.

The first point of interest is the average daily expenditure for war purposes. In all the belligerent countries it naturally took some time for them to get into their stride. This is especially true of Great Britain. The figures of the average daily expenditures, as given by the chancellors of the exchequer, amount to almost ten million dollars for the opening months of the war and reached the maximum of almost thirty-six millions by 1918. These stupendous figures, however, are somewhat exaggerated, because no distinction is made between expenditures in the war and expenditures for the war. In order to ascertain the real war expenditures in any country, it is obvious that we must deduct the amount of ordinary or peace expenditures. This it is not always easy to do. In the first place, peace expenditures themselves tend to grow from year to year. If, therefore, we take as a criterion the ordinary expenditures for the year preceding the war, this sum ought, expecially in a long war, to be somewhat increased from year to year. In the second place, the expenditures prior to the war may sometimes include preparations for an impending war and should therefore be reduced accordingly. Since, however, it is impracticable to make these detailed corrections in every case, it will suffice to deduct from the expenditures of each war year the amount of the expenditures in the last year of peace, even though this tends slightly to exaggerate the real money cost of the war. Making these corrections, it appears from Table A that the average daily war expenditures in Great Britain grew from 9½ million dollars during the first eight months of the war to 33½ millions in 1918 and then slowly receded. In France the average daily expenditures, as was to be expected, were somewhat less, rising from about 8½ million dollars during the first three months of war to over 21 millions during 1917, the last full year of war. In Germany the daily expenditures

were approximately the same as in Great Britain, rising from about 13 million dollars in the first nine months of the war to about 34½ millions during the last half of 1918. In the case of both Germany, and France, however, it is not known whether the figures comprise the total expenditures or only the purely war expenditures. In the former event, the daily expenditures of Germany would be a little less than those of Great Britain; in the latter, they would be a little more. In Italy and Austria, the daily expenditures were naturally smaller, amounting as a maximum to 10½ and 20 millions respectively. In Russia the daily expenditures rose in 1916 to 21 millions, and in 1917, just prior to the October revolution, nominally to 47 millions. Owing to the great depreciation of the ruble, however, the actual expenditures were much less. The salient facts are given in Table A.

TABLE A.—AVERAGE DAILY WAR EXPENDITURES

(In millions)

GREAT BRITAIN

	Average daily total expenditures			Average daily war expenditures [1]	
		£	$	£	$
Aug. 4, 1914—Mar. 30, 1915		2.05	9.98	1.98	9.46
Apr. 1, 1915— " 1916		4.27	20.79	3.73	18.16
" 1916— " 1917		6.02	29.33	5.48	26.69
" 1917— " 1918		7.39	35.97	6.85	33.36
" 1918—Nov. 9, 1918 (Armistice)	7.44	7.07	34.43	6.52	31.75
Nov. 10, 1918—Mar. 30, 1919	6.47				

FRANCE

	Average monthly war expenditures		Average daily war expenditures	
	fr.	$	*fr.*	$
Aug. 3—Dec. 31, 1914	1,318	254	439.6	8.5
Jan. 1—Dec. 31, 1915	1,900	367	633.3	12.2
" — " 1916	2,743	529	914.3	17.6
" — " 1917	3,360	648	1,120.0	32.4

[1] Arrived at by deducting the expenditures for the year 1913-1914 (£197 millions) from the total expenditures.

GERMANY

	Average monthly war expenditures		Average daily war expenditures	
	Mk.	$	*Mk.*	$
Aug. 1, 1914—June 30, 1915	1,675	398.6	55.8	13.3
July 1, 1915— " 1916	2,008	461.8	66.9	15.9
" 1916— " 1917	2,867	682.2	95.6	22.7
" 1917— " 1918	3,908	930.1	130.3	31.
" 1918—Dec. 31, 1918	4,358	1,037.2	145.2	34.5

ITALY

	Annual expenditures [1]		Average daily expenditures
	li	$	$
July 1, 1915—June 30, 1916	3,351	1,612	4.4
" 1916— " 1917	14,132	2,727	7.5
" 1917— " 1918	19,734	3,808	10.4
" 1918—Oct. 31, 1918	9,726	1,977	6.5

RUSSIA

	Annual war expenditures		Average daily war expenditures
	ru.	$	$
Aug. 1, 1914—Dec. 31, 1914	1,703	877	5.8
Jan. 1, — " 1915	9,194	4,735	12.9
" — " 1916	15,372	7,916	21.6
" —Oct. 30, 1917	25,231	12,993	47.0

AUSTRIA-HUNGARY [2]

	Annual war expenditures		Average daily war expenditures
	Kr.	$	$
July 28, 1914—June 30, 1915	10,706	2,714	6.4
July 1, 1915— " 1916	15,726	3,192	8.7
" 1916— " 1917	18,788	3,812	10.4
" 1917— " 1918	22,170	4,500	12.3

When the United States entered the war, the scale of operations became so gigantic that the daily war expenditures soon far exceeded those of any other belligerent. In the second month of the war the average daily expenditures for war purposes reached 15 million dollars, and a little over a year later

[1] Not including payments abroad.

[2] The figures for Hungary are not available; but as the total expenditures of Hungary during the four years were about one-third of those of Austria, it is safe to add that proportion to the Austrian expenditures in order to ascertain the average daily war expenditures of Austria-Hungary.

they had risen to almost 50 millions. By the end of 1918, as appears from Table B on the following page, the daily average war expenditures attained the staggering sum of 64½ million dollars, almost double those of Great Britain and far exceeding those of any other belligerent.

We come next to the total cost of the war. In attempting to present the comparative statistics on this point, we must be mindful of the difficulties adverted to above. The figures are not quite accurate and cannot be made entirely accurate for several reasons. In the first place, the last date in the official return differs from country to country. The dates are, however, all subsequent to the armistice, with the exception of Russia, where we have no trustworthy figures after the October revolution in 1917. In the second place, we do not know, except in the case of the United States and Great Britain, whether the figures comprise the total expenditures or only the purely war expenditures. Even in the case of the United States the official figures are not quite accurate, as will be seen below.[1] Moreover, in the case of Japan as well as some of the minor belligerents, no figures are included because the war expenditures were either virtually non-existent or of an exceedingly insignificant amount.

Making allowance for these points, it will be seen from Table C that the total war expenditures amount to about 232 billion dollars. From this sum, however, must be deducted the amounts counted twice, because advanced to their allies by the United States, Great Britain, France and Germany, aggregating a little over 21 billions. This would bring the actual net war expenses to over 210 billion dollars.[2] Inasmuch, however, as most of the countries will continue, for some little time in the future, to have expenditures attributable to the war, it is probable that the total war expenditures will, by the end of 1920, amount to over 236 billions, or, deducting the advances to allies, to a little less than 215 billions. This may be accepted as a fairly accurate statement of the real money cost of the war.[3]

[1] *Infra*, p. 763, note to Table H.

[2] For France we have taken the total five-year expenditures as stated by Minister Klotz in 1919 (192 billion francs) and have deducted 23 billions, as representing the peace expenditures for the four and a half year period, thus leaving a remainder of 169 billion francs or 31½ billion dollars.

[3] These figures are considerably larger than those given by Ayres and other writers. But none of these authors uses the later, and much augmented, official figures for France, Italy, and especially Germany.

TABLE B.—EXPENDITURES OF THE UNITED STATES

(In millions)

Period	Monthly expenditures exclusive of the principal of the public debt and of postal expenditures	Monthly war expenditures[1]	Average daily war expenditures
1917: Apr. 6–30	$279	$219	$ 8.0
May	527	467	15.0
June	410	350	11.7
Total, Apr. 6–June 30	$ 1,216	$ 1,156	
July	662	602	19.4
August	757	697	22.5
September	746	686	22.9
October	944	884	29.5
November	986	926	30.9
December	1,105	1,045	33.7
1918: January	1,090	1,030	33.2
February	1,012	952	34.0
March	1,156	1,096	35.9
April	1,215	1,155	38.5
May	1,508	1,448	46.7
June	1,512	1,452	48.4
Total, fiscal year 1918	$12,697	$11,977	
1918: July	1,608	1,548	49.9
August	1,805	1,745	56.8
September	1,557	1,497	49.9
October	1,665	1,605	51.8
November	1,935	1,875	62.5
December	2,061	2,001	64.5
1919: January	1,962	1,902	61.4
February	1,189	1,129	40.0
March	1,379	1,319	42.5
April	1,429	1,369	45.6
May	1,112	1,052	33.9
June	809	749	24.9
Total, fiscal year 1919	$18,505	$17,785	
Total, Apr. 6, 1917–June 30, 1919	$32,428	$30,918	

[1] Obtained by deducting one-twelfth of the annual (peace) expenditures for 1915–1916 exclusive of postal expenditures: *i. e.*, one-twelfth of $1,008—287 millions = 60 millions. Secretary Glass in his *Letter of July 9, 1919, to the Chairman of the Committee on Ways and Means* excludes postal expenditures in the first column, but fails to exclude them when making the deduction for peace expenditures. He consequently arrives at the figure of $30,177 millions as the cost of the war. The total of $30,918 millions given above does not, however, represent accurately the war expenditures, as the figures are based on the provisional daily treasury statements used

The figures, it must be remembered, cover the cost of the war up to a period from six to twelve months after the conclusion of hostilities. In many countries, however, large expenses directly connected with the winding up of the war continued, and in any final statement the prodigious figures of the cost of reconstruction and reparation would have to be added. These will without much doubt ultimately well-nigh double the above estimate.

TABLE C.—TOTAL WAR EXPENDITURES

(In millions)

Great Britain	Aug. 4, 1914–Mar. 31, 1919	£8,601	$41,887	
Australia	" " " – " " "	291	1,461	
New Zealand	" " " – " " "	76	365	
Canada	" " " –Aug. " "		1,545	
South Africa	" " " –Mar. " "	33	243	
India	" " " – " " "	119	584	
British Empire				$46,085
France	Aug. 3, 1914–Mar. 31, 1919	fr. 169,000	32,617	
Russia	Aug. 1, 1914–Oct. 31, 1917	ru. 51,500	26,522	
Italy	May 23, 1915–May " 1919	li. 81,016[1]	15,636	
Belgium	Aug. 2, 1914–Oct. " 1918	fr. 5,900	1,387	
Rumania	" 27, 1916– " " "		907	
Serbia	July 28, 1914– " " "		635	
United States	April 5, 1917–June 30, 1919		32,261	
Entente Powers				156,050
Germany	Aug. 1, 1914–Oct. 31, 1919	mk. 204,268	48,616 [2]	
Austria-Hungary	July 28, " –July " "	kr. 119,504	24,858 [3]	
Turkey	Nov. 3, " –Oct. " 1918		1,802	
Bulgaria	Oct. 4, 1915– " " "		732	
Central Powers				76,008
Total				$232,058
Loans to Allies				
Great Britain		£1,739	$8,467	
France		fr.6,700	1,293	
Germany		mk.9,500	2,261	
United States			9,102	
Total				21,123
Total net war expenditures				$210,935

II. *The Revenues*

The question now arises as to the steps taken by the various countries to meet these stupendous outlays. Of the older expedients, such as war treasures or the sale of public property, there was naturally no question. In Germany alone was there

by Secretary Glass. The correct total, arrived at in another way, will be found in Table H below. But the above figures are the only ones available for calculating the monthly and daily expenditures.

[1] The total expenditures were li. 91,016 millions. Deducting 10,000 millions for four years of peace expenditures leaves 81.016.

[2] Obtained by adding to the war debt as found in Table R approximately 5 billion marks of war expenditures paid out of revenue.

[3] Obtained by using the figures of war debt as found in Table R.

a war treasure. But, as even this was so small as to be well-nigh negligible, it follows that the only two available resources were taxation and borrowing.

When we compare these two expedients we are struck not only by the great difference in the theories of war finance followed by the various countries, but also by the diversity in the economic conditions which largely influenced the choice. In general, it may be said that all countries were compelled to rely to an overwhelming extent on public loans, but that Great Britain and the United States raised a greater share by taxation than did other countries. Italy, for instance, was able to secure by new taxation only just about enough to pay the interest on the war loans; Germany accomplished this only in part; while France was not in a position to defray any of her war expenses from taxation. The same is true of the other belligerents, with the exception of some of the British colonies.

Proceeding to consider this matter in detail, we shall first attempt to set forth the facts as to war taxation.

Great Britain, as the wealthiest of the belligerents, adopted at the outbreak of war the praiseworthy method of endeavoring to raise as much as possible from taxation. From year to year, as the expenses mounted up, continually more demands were made upon the taxpayer. The war expenditures were, however, so prodigious that it soon turned out to be impracticable to obtain more than a comparatively small proportion of the total outlay from taxation. The figures ordinarily advanced to illustrate this point do not, however, give a true picture of the situation. The statements made by the various chancellors of the exchequer, and repeated by all commentators, are based on the proportion that total taxes bear to total expenditures. This method of calculation, as will be seen from Table D, shows that almost a quarter of the total expenditures or, to be more exact, 24.9 per cent, was derived from taxes. These figures, however, involve a double error. In the first place, the really significant problem is to ascertain the war expenditures, not simply the total expenditures. War expenditures can best be obtained, as we have seen, by deducting from the total annual expenditures the expenditures for the last full year of peace. In the second place, what is significant is not the total yield of all taxes, but the proceeds of war taxes, that is, the proceeds of the additional taxes raised during the war. These again can be obtained by deducting from the total tax revenue the

yield of the taxes during the last full year of peace. If then we endeavor to ascertain how much of the war expenditures were met by war taxes—and this is really the important problem—we find that, immense as were the burdens resting upon the British taxpayer, the percentage of war expenditures raised by war taxes was much smaller than is usually stated. As a matter of fact, as appears from Table D, in the first year of war only a little over 7 per cent of the total war expenditures were raised from war taxes. With every succeeding year, indeed, the percentage increased until in the last year of war, 1918–1919, slightly over one-quarter of the war expenditures were met from war taxes. For the entire five years, however, the proportion of war taxes to war expenditures was about 17 per cent. In other words, only a little more than one-sixth of the war expenditures in Great Britain was derived from war taxes. Even if we exclude from the war expenditures the sums advanced to the Allies—and the Chancellor of the Exchequer, Mr. Chamberlain, thinks it safe to allow for only half of this amount—the proportion would be a little over 21 per cent or slightly more than one-fifth. These figures are much less than is ordinarily stated. But even this proportion of revenue derived from taxation was sufficient to maintain the credit of Great Britain.

In the other belligerent countries, the showing was by no means so good. France struggled under a double difficulty. In the first place, France was invaded at the outset of the war; and the territory occupied, although relatively small in extent, represented the richest and the most industrially developed part of the country. This operated largely to reduce the ordinary revenue. In the second place, the resultant economic confusion, as well as the general political situation, rendered it difficult to impose any new taxes at all. The consequence, as will be seen from Table E, was that for the first three years of the war the tax revenues of France were actually smaller than before the war and that as a result they did not suffice even to defray the ordinary peace expenditures, not to speak of making any contribution to war expenditures.

After a while, indeed, France found it possible to levy some war taxes; but, as appears from Table E, these were exceedingly slight compared with what had been accomplished in Great Britain. The consequence is that the new war taxes of France were only just about sufficient to make up the deficit in the

TABLE D.—WAR EXPENDITURES OF GREAT BRITAIN

(In millions sterling)

	Year ending March 30					Total for the five years 1915–1919
	1915	1916	1917	1918	1919	
	£	£	£	£	£	£
Total expenditures	560	1,559	2,198	2,696	2,579	9,592
War expenditures [1]	357	1,362	2,001	2,499	2,382	8,601
Loans to Allies and Dominions						1,739
Revenues other than loans	227	337	573	707	889	2,733
Tax revenues	189	290	514	613	784	2,390
War tax revenues [2]	26	127	351	450	621	1,475
	P. c.	*P. c.*	*P. c.*	*P. c.*	*P. c.*	*P. c.*
Proportion of total expenditures from non-loan revenues	40.5	21.6	25.1	26.2	34.1	28.1
Proportion of total expenditures from taxes	33.7	18.6	22.4	22.7	30.4	24.9
Proportion of war expenditures from war taxes	7.3	9.3	17.5	18.0	26.0	17.1
Proportion of net war expenditures (less loans to Allies and Dominions) from war taxes						21.2

TABLE E.—REVENUES OF FRANCE [3]

(In million francs)

	1913	1914	1915	1916	1917	1918
Direct taxes	634	611	547	550	730	696
War-profits tax	...	...	...	...	209	578
Tax on securities	138	153	157	181	242	253
Stamp taxes	1,086	815	610	685	896	1,143
Indirect taxes	903	763	730	713	1,018	1,138
Customs duties	754	579	764	1,400	1,511	1,186
Tax on sales	...	...	...	...	...	112
Monopolies	1,035	942	853	950	1,116	1,158
Public domain and miscellaneous	539	333	469	453	464	527
Total	5,089	4,196	4,130	4,932	6,186	6,791

[1] Obtained by deducting from the total expenditures each year the peace expenditures for 1914, amounting to 197 millions.

[2] Obtained by deducting from the tax revenues the 1914 tax revenue, amounting to 163 millions.

[3] These final figures are arranged from the tables in *Bulletin de Statistique*, v. 89 (1921), p. 625 and v. 91 (1922), p. 849.

ordinary peace budget—a deficit caused chiefly by the devastation of the occupied territory. In France, therefore, we may conclude that no part of the war expenditures was met by war taxes. A share of the responsibility for this fact must, however, be laid at the doors of the government, which disclosed an unwarrantable timidity in levying taxes. The natural results of the adoption of the loan policy in the fiscal conduct of the war are seen in the exaggerated rise of prices, the depreciation of the franc, and the serious condition of finances in France to-day.

In Italy the situation was a little better. Italy had not been invaded, and its financial situation was not so desperate as that of France. Moreover, Italy entered the war somewhat later and was not compelled to endure the strain for so long a time. Italy consequently proceeded as soon as possible to levy new war taxes; but, as she had always been relatively overtaxed as compared with Great Britain, it was not feasible to do as much. As a result, the war taxes levied by Italy were just about sufficient to pay the interest on the war loans. While Italy, therefore, did better than France, she also was not able to defray any of the war expenditures proper out of war taxation.

The condition of Russia soon became worse than that of France and Italy; and even before the October revolution in 1917 Russia was able to put very little reliance upon revenue from war taxation.

Among the Central Powers the situation was much the same, but for a different reason. Germany at the outset of the war, had so confidently counted upon victory, with resultant huge indemnities, that it resolved to follow the loan policy, at all events so far as the imperial government was concerned. For it must be remembered, that in Germany a not insignificant part of the war expenses was met by the separate states; and in the states a considerable increase of taxation was provided for at once. As the war proceeded, however, and the hopes of a speedy and complete victory gradually faded away, Germany began to change her policy and now decided, especially from 1916 on, to impose more and more taxes. The result was that by the end of the war, Germany had done a little better than France although a little less well than Italy. The figures for the chief continental belligerents are given in Table F.

If the later figures as presented by Minister Erzberger are used, the showing is not appreciably more favorable. According to these figures, of the total war expenditures to October, 1919,

of about 204 billion marks, about 5 billions were derived from other sources than loans.

TABLE F.—REVENUES AND EXPENDITURES: FRANCE, ITALY, GERMANY

(In millions)

FRANCE

	Expenditures	Income	
	fr.		*fr.*
Aug. 1, 1914–Mar. 31, 1919	174,500	Loans	159,400
Advances to Allies	6,700	Other revenues	22,500
	181,200		181,900
Foreign debts and other minor items	11,000		
Total	192,200		
Annual revenues before the war			5,000
Total peace revenues during the war period			24,000

Hence the total non-loan revenues during the war did not quite equal the peace revenues calculated on the pre-war basis.

ITALY

	Expenditures	Income	
	li.		*li.*
May, 1915–June 30, 1918	87,516	Loans	64,132
Still due	3,500	Other revenues	26,034
Total	91,016	Total	90,166
Annual peace revenues			2,687
Total peace revenues during the war period			13,435
Deducting 13,435 from 26,034 leaves as war revenue			12,599

Hence the war revenues barely sufficed to pay the interest on the war loans.

GERMANY

	Expenditures	Income	
	mk.		*mk.*
Aug. 1, 1914–Dec. 31, 1918	170,300	Loans	153,000
		Other revenues	17,000
		Total	170,000
Annual peace revenues (1913)			3,200
Total peace revenues for 4½ years of war			14,400
Deducting 14,400 from 17,000 leaves as war revenue			2,600

The war revenues thus did not suffice to pay the interest on the war loans.

We come, finally, to the experience of the United States. When the United States entered the war, it was confronted by the two rival theories of public finance. One was to the effect that the war expenses should be defrayed entirely by loans, as

had been the case in the early years of the Civil War and which was true, as we have just seen, of many of the belligerents during this war. The other theory, advanced especially in the famous Minnesota memorandum,[1] was that the war expenditures ought to be defrayed entirely out of war taxes. This theory was equally as extreme and as perilous as the loan theory and labored under the additional disadvantage of being impossible of achievement. The President went so far as to proclaim the fifty-fifty per cent theory, namely that one-half of the war expenditures ought to be defrayed from war taxation. But even this turned out, as was to have been expected and as was pointed out by the present writer among others, to be far more than was possible.

The prodigious profits made during the opening years of the European war and the resulting prosperity throughout the country enabled Congress to levy taxes far higher than had ever before been attempted in our history. Even with an immense addition to taxation, however, the proportion derived from war taxes was relatively small, and in fact considerably smaller than is ordinarily stated. Here, again, we must observe the same caution as in the case of the British figures. We must not compare the total expenditures of the war period with the total taxes of the war period, but war expenditures with war taxes—which is something very different. In Tables G and H an attempt is made, on the basis of certain official figures, to arrive at correct results. The explanation of the methods of calculation is found in the notes appended to the tables; and the reasons for the difference between the results here given and the statements of the secretaries of the treasury are presented in the general note below.[1]

[1] The Minnesota memorandum, signed by a number of economists, was so called because it was drafted by some of the instructors at the University of Minnesota.

[2] The figures, unless otherwise stated, are taken from the annual *Reports of the Secretary of the Treasury on the Finances* for 1918 and 1919. A preliminary estimate will be found in Secretary Glass' *Letter of July 9, 1919, to the Chairman of the Committee of Ways and Means,* which served as the basis of the (slightly different) conclusions arrived at by the present writer in the original article from which this chapter is reprinted,

The figures as presented in the tables, do not, however, always agree with the official statements. In the first place it is difficult to know what are the official figures, as they frequently differ among themselves. For instance, the figures found in the tables of the *Annual Report* for 1918, pages 480 *et seq.* (hereinafter called A), do not tally with those in the text

As a result of the calculations found in Tables G and H it appears that during the first quarter year of war, ending June 30, 1917, the proportion of war expenditures derived from war taxes was less than one-third or, more exactly, 30 per cent. If we exclude from the expenditures the loans to the Allies, on the problematical assumption that they will all be repaid some day, the showing in the first three months is, of course, much better, as two-thirds of the expenditures of that period consisted of such loans. However, as soon as we struck our full gait, the situation was far less satisfactory. During the year 1917–1918 the proportion of war expenditures derived from war taxes was

of Secretary McAdoo's comments in the *Annual Report*, pages 3-5 (hereinafter called B), nor with the figures of Secretary Glass in his *Letter of July 9* (hereinafter called C). In some cases the discrepancies are serious.

Thus in A the receipts for 1917 are given (including postal receipts of 330 millions) as 3,845 millions; in B, as 3,552 (excluding postal). For 1918 again, the receipts are given in A as 21,490 millions (including postal receipts of 344 millions); in B, as 21,155 millions (excluding postal). In A the disbursements for 1917 are given as 3,046 millions (including postal disbursements of 320 millions); in B, as 2,704 (excluding postal). For 1918 the respective discrepancies are: A, 21,813; B, 20,903. Even in minor details there are no agreements. Thus public debt receipts are given for 1917 in A as 2,391 millions; in B, as 2,428 millions. For 1918 the figures are respectively: A, 16,965; B, 16,975. Public debt disbursements are given for 1917 in A as 637; in B, as 678 millions. For 1918 they are given in A as 7,685; in B, as 7,707 millions. If there is any significance in the fact that A gives tables of "Receipts and Disbursements" while B gives tables of "Receipts and Expenditures," it is not apparent from the report itself. Similar discrepancies are found in Secretary Glass' Annual *Report* for 1919.

The discrepancies between A and C are more glaring. But as Secretary Glass was able to present only preliminary figures for the respective periods, on the basis of the daily treasury statements, these discrepancies may be overlooked.

In the second place, considerable confusion results from the absurd system still followed in the United States, whereby postal revenues and expenditures go through the post office accounts and only the surplus or deficiency passes through the treasury accounts. Several years ago the present writer succeeded in inducing the Treasury Department to bring about a change to this extent that the annual treasury statements are now made up in both ways, *viz.*, as revenues and expenditures inclusive and exclusive of postal revenues and expenditures respectively. Yet these differences are often overlooked. For instance, when Secretary Glass discusses in his *Letter of July 9, 1919*, the cost of the war, he employs the daily treasury statements which do not include the postal figures. As a consequence, his statement of total revenues and expenditures are quite different from those of Secretary McAdoo in the latter's discussion of the cost of the war.

In the third place, neither Secretary McAdoo nor Secretary Glass, in cal-

less than a quarter or, more exactly, only 24.8 per cent; and even if we again exclude loans to Allies, which now constituted about one-third of the whole, only 39 per cent of the expenditures were derived from war taxes. In the final year of the war the showing was still less favorable, the figures being respectively 18.6 per cent and 23 per cent, *i. e.*, a little less than one-fifth or one-fourth respectively. For the entire period of our participation in the war it appears that only slightly over one-fifth (or exactly 21.59 per cent) of the war expenditures were paid out of war taxes. And if the loans to Allies are again excluded, the proportion is still under one-third or, more exactly, 30.32 per cent.

culating the proportion borne by loans and taxes in meeting the war expenses, attempts to ascertain the really significant fact—*viz.*, the proportion of war expenditures met from war taxes. None of the official figures are of any help here.

The present writer has therefore been compelled to make his own calculation. Whenever possible, the figures have been taken from the statements in the detailed tables published in the *Annual Report* of the Secretary of the Treasury. The combinations, however, as found in this chapter are not presented anywhere in the official statements.

Some of the results reached in this chapter which differ materially from the official statements, are as follows:

The total cost of the war to June 30, 1919, is given by Secretary Glass as \$30,117 millions, whereas the more accurate computation results in a total cost of \$32,694 millions. Secretary Glass's figures involve a double error. In the first place, they are based on the preliminary daily treasury statements which are confessedly not final; and, as explained in the note to Table B (p. 764, *supra*), he fails to allow for postal expenditures. In the annual *Report* for 1919 Secretary Glass gives his revised figures of the cost as \$32,830 millions. He reaches this result by taking the peace expenditures at a round sum. Again, Secretary McAdoo states that in 1917 55 per cent of the expenditures were paid from revenue receipts, and in 1918 31.6 per cent; whereas the correct figures are 60.4 per cent and 33.8 per cent respectively, and the really significant figures (the proportion of war expenditures from war taxes) are 30 and 24.8 per cent respectively. In the annual *Report* for 1919 Secretary Glass states on p. 25 that "nearly 32%" of the disbursements during the war period April 6, 1917, to Oct. 31, 1919, was "met out of tax receipts and other revenues than borrowed money." This does not differ much from our figures of 31.16%. But the Secretary says nothing about the really important point—the relation between war expenditures and war taxes. On the other hand, in the *Report* for 1920 where Secretary Houston continues the figures to June 30, 1920, he estimates the total cost of the war to that date at \$33,455 millions, and figures, on the basis of some rather dubious calculations, that war taxes supplied 32% of the war expenditures. Apart from all other objections, it is obviously entirely misleading to continue the figures during the fiscal year 1920 when the war taxes remained almost unabated, but when the so-called war expenses were only those of the aftermath of the war.

TABLE G.—RECEIPTS AND DISBURSEMENTS OF THE UNITED STATES, 1915–1919

(In millions)

Receipts	Year ending June 30				
	1915	1916	1917	1918	1919
Customs	$ 211	$ 213	$ 226	$ 183	$ 183
Internal revenue	416	513	809	3,696	3,840
Miscellaneous	71	52	81	293	624
Total ordinary receipts	698	780	1,119	4,174	4,648
Panama canal	....	....	6	6	7
Excess of deposits to retire national banknotes	4	32	...	....	....
Postal receipts	287	312	330	344	365
Total (exclusive of principal of public debt)	989	1,126	1,455	4,795	5,020
Public debt receipts	1	2	2,391	16,695	29,053
Total	990	1,128	3,845	21,490	34,073
Disbursements					
Ordinary (exclusive of postal)	$ 725	$ 719	$2,067	$13,769	$18,939
Including loans to Allies	....	....	(885)	(4,738	(3,793)
Panama	29	18	19	21	12
Postal	294	312	320	327	363
Excess of national banknotes retired over deposits	....	....	3	11	1
Total (exclusive of principal of public debt)	1,048	1,048	2,409	14,127	19,302
Public debt disbursements	0.05	0.04	637	7,686	15,814
Total	$1,048	$1,048	$3,046	$21,813	$35,130

These figures disclose two significant facts. In the first place, the relative revenue derived from war taxes became smaller, instead of larger, as the war proceeded. This unusual and unexpected result is, of course, due to the stupendous growth of war expenditures which rapidly overtook even the largely increased revenues from war taxes. It was impossible, even by stretching the tax revenues to the utmost, to begin to keep pace with the huge growth in the war outlays. In the second place, we are struck by the great disparity between the actual facts and the fifty-fifty per cent program originally suggested by Secretary McAdoo and adopted in the recommendation of President Wilson—not to speak of the one hundred per cent program of the Minnesota memorialists.

TABLE H.—RECEIPTS AND EXPENDITURES OF THE UNITED STATES, APRIL 5, 1917–JUNE 30, 1919

(In millions)

	1917	1918	1919	Total for period Apr. 5, 1917–June 30, 1919
Total disbursements [1]	$3,046	$21,813	$35,130	$59,989 [5]
Total expenditures, exclusive of principal of the public debt [1]	2,409	14,127	19,302	35,838 [5]
War expenditures [2]	1,361	13,079	18,254	32,694
Loans to Allies [1]	885	4,738	3,793	9,416
War expenditures exclusive of loans to Allies	476	8,341	14,461	23,278
Revenue exclusive of public debt [1]	1,455	4,795	5,020	11,270
Tax revenues [3]	1,035	3,879	4,023	8,937
War tax revenues [4]	409	3,253	3,397	7,059
	P. c.	*P. c.*	*P. c.*	*P. c.*
Proportion of total expenditures from non-loan revenues	60.4	33.8	26.00	31.16
Proportion of total expenditures from taxes	42.9	27.4	20.83	24.91
Proportion of war expenditures from war taxes	30.	24.8	18.61	21.59
Proportion of war expenditures exclusive of loans to Allies from war taxes	85.7	39.	23.62	30.32

III. *The War Taxes*

The next point of interest is the character of the war taxes imposed by the various countries. Here again we notice great variations. Although the policy of taking a substantial share of war profits by taxation was almost everywhere adopted as a matter of principle, it was applied very differently in various countries. As a matter of fact, in almost all of the continental countries, about as much additional revenue was raised from indirect as from direct taxation. Indeed, in France considerably more revenue was designed to be raised from indirect taxes, including taxes on consumption, than from direct taxation or taxes on wealth. The respective figures, as appears from Table I, are about 60 per cent for indirect and 40 per cent

[1] From Table G.

[2] Obtained by deducting from total expenditures the (peace) expenditures of 1915 ($1,048).

[3] Obtained by adding the customs and the internal revenue.

[4] Obtained by deducting from the tax revenues for 1915 (626 millions).

[5] Total for the three fiscal years 1917, 1918, 1919.

for direct taxes. In actual result, the increase due to indirect taxation was not so great as had been expected, due partly to the fact that the war-profits tax yielded much more than had been anticipated (907 million francs instead of 540 millions), but above all because the tax on sales produced in the first year far less than had been hoped for (210 instead of 800 million francs). As a consequence, the proportions derived from direct and indirect taxes were actually just the reverse of those mentioned above, namely, about 60 per cent from direct and about 40 per cent from indirect taxes.

TABLE I.—REVENUE EXPECTED FROM INCREASED TAXES IN FRANCE, 1914–1918

(In million francs)

Direct		Indirect	
War-profits tax	540	Alcoholic drinks	75
Military war tax	12.5	Non-alcoholic drinks	85
Income tax	250	Druggists specialties	12
"Assimilated taxes"	24	Sugar	90
Inheritance tax	148	Colonial products	70
Intangibles	38	Tobacco	80
Land tax	30	Postage	58.5
		Theatres	10
		Sales	800
	1,042.5		1,280.5
Additions of June, 1918:		Additions of June, 1918:	
Income tax / Inheritance tax	56	Stamp taxes	76
		Other indirect taxes	333
	1,098.5 or 39.3 per cent		1,689.5 or 60.7 per cent

In Italy, where the new war taxes were imposed at once in 1915, it was expected that the war-profits tax (at the rate of from 8 to 20 per cent) would yield about 55 million lire, and the augmented taxes on incomes and business about 220 millions, or a total of 275 millions from direct taxes compared with an estimated revenue of 110 millions from various increases in indirect taxes.

In 1916, however, while the rate of the war-profits tax was increased so as to vary from 20 to 60 per cent and that of the income tax to about 16 per cent, the stamp taxes were raised and the number of state monopolies was increased. The same policy was followed during the next year so that by the end of the war, in addition to the old government monopolies on

tobacco, salt, matches, lotteries, and cards, we now find monopolies on coffee, paraffine, and mineral oils, quinine, and various minor objects. The result was that in 1918 just about as much additional revenue was derived from the new indirect taxes as from the new direct taxes. The exact figures are as follows: the direct taxes, technically so called, yielded 1,500 million lire and the business taxes 560 millions, or a total of 2,060 millions. On the other hand, the increased revenue from monopolies amounted to 1,060 millions and that from the new consumption taxes 950 millions, or a total of 2,010 millions. In Italy, therefore, the balance was kept just about even between the two great categories of taxation.

In Germany when the government finally decided to resort to taxation in 1915, no effort was made to impose any new taxes on incomes or inheritances. For the feeling was still very strong that income and property taxes ought to be left to the separate states, which had in the meantime considerably increased their revenue from such sources. A federal tax on war profits was, however, imposed. On the other hand, the tax on tobacco was largely increased, a high tax was levied on bills of lading, and a considerable augmentation was made in postal, telegraph, and telephone rates. From all these sources an additional revenue of about 500 million marks was expected. When the bill passed through the Reichstag, a tax on sales was added, estimated to yield about 130 millions. In the next year, 1917, the war profits tax was considerably increased, so as to produce about 400 million marks additional; but, on the other hand, a high tax on coal was now imposed, designed to yield 500 million marks and provision was made for a tax on railroad transportation to yield 310 millions. Finally, in 1918, the government recognized the necessity for very much greater revenues from taxation and a law provided for additional receipts estimated at 3 billions of marks, on the one hand, from an increased tax on war-profits and, on the other, from taxes on sales, luxuries, and higher rates on drinks and postal communication. The exact figures as to the proportion between the two categories of taxation are not yet available; but it is quite safe to say that in the federal government, at least, the revenue from indirect taxes considerably exceeded that from direct taxes. In the separate commonwealths the situation was the reverse, without, however, materially changing the general result.

In contrast to all the continental countries, England pursued

from the outset a different path. It is true that a considerable increase of revenue was derived from indirect taxes like custons and excises. From 1914 to 1919, for instance, the customs revenues were actually trebled and the yield of the excise taxes increased about 50 per cent. But the chief reliance for meeting the war expenditures was placed on a new war-profits tax and an augmented income tax. The rate of the war-profits tax was raised gradually from 50 to 60, and finally to 80 per cent; and the income tax rates were progressively increased until from a quarter to a third of very moderate incomes and over a half of larger incomes were taken for the state. In the last year of the war, as appears from Table K, over three-quarters of the tax revenue was derived from direct taxes on wealth. This is a great contrast to the fiscal history of previous wars.

In the United States, also, we find the democratic movement so strong that the overwhelming proportion of the new tax revenue was derived from direct taxation on wealth rather than from indirect taxes on consumption or transactions. Although the excess-profits tax was not at first levied at rates as high as in Great Britain, the remarkable prosperity of the country resulted in large revenues from this source. And while the income tax did not reach in the lower stages so high a level as the British, the rates in the upper schedules were made considerably higher, finally attaining the unheard of figures of 77 per cent. As a result of the revenue act of 1917 over 79 per cent of the tax revenue came from direct taxation, principally the income tax and the excess-profits tax. After the second great revenue act of 1918 was enforced, the proportions were still more favorable, the amount ascribable to direct taxation in 1919 being, as appears from Table L, in reality almost 81 per cent, although the introduction of the system of payment by instalments somewhat obscured this result.

It thus appears that the United States succeeded even better than Great Britain in carrying through a democratic fiscal program in the war; and that the Anglo-Saxon countries disclose a very decided contrast to all the other belligerents. The consequences are apparent in the relatively more favorable situation in which Great Britain and the United States found themselves when confronting the problems of *post-bellum* finance.

TABLE K.—SOURCES OF REVENUE IN GREAT BRITAIN, 1914–1919

(In millions)

	Year ending March 30											
	1914		1915		1916		1917		1918		1919	
	£	*P.c.*	£	*P.c.*	£	*P.c.*	£	*P.c.*	£	*P.c.*	£	*P.c.*
Customs	35	17.8	39	6.9	60	4	71	3	71	3.3	103	4
Excise	40	20	42	7.5	61	4	56	2.2	39	1.4	59	2.2
Estate duties	27	13.8	28	5	31	2	31	1.4	32	1.2	30	1.1
Stamps	10	5	6	1.3	7	0.4	8	0.3	8	0.3	12	0.5
Land tax	.7	0.4	.7	0.1	.7	0.04	.6	0.03	.7	0.04	.6	0.02
House duty	2	1	2	0.3	2	0.1	2	0.09	2	0.09	2	0.7
Income tax	47	23.8	69	12.4	128	9	205	9	240	8.9	291	11.2
Excess-profits tax	—	—	—	—	.1	0.01	140	6	220	7.3	285	11
Land values tax	.7	0.4	.4	0.1	.4	0.02	.5	0.03	.7	0.03	.7	0.02
Total tax revenues	163	82.2	189	33.6	290	19.17	514	22.27	613	22.56	784	30.74
Postal, Telg., Teleph.	31	15.5	30	5.3	34	2.1	34	1.4	35	1.4	40	1.6
Crown lands	.5	0.3	.5	0.1	.5	0.03	.6	0.03	.7	0.04	.8	0.02
Suez Canal shares	2	1	1	0.3	2	1	8	0.2	6	0.3	12	0.44
Miscellaneous	2	1	6	1	10	0.7	17	0.5	52	2	52	2
Non-tax revenues	35	17.8	37	6.8	47	3.83	59	2.13	94	3.74	105	4.06
Total tax and non-tax revenues	198	100	227	40.4	337	23	573	24.4	707	26.3	889	34.8
Loans	3		407	59.6	1,165	77	1,626	75.6	1,983	73.7	1,682	65.2
Total revenues	202		633	100	1,501	100	2,199	100	2,691	100	2,571	100
Total expenditures	197		560		1,559		2,198		2,696		2,579	
Interest on debt	24		23		60		127		190		270	

TABLE L.—INTERNAL REVENUE RECEIPTS OF THE UNITED STATES, 1918, 1919

(In millions)

	Year ending June 30			
	1918		1919	
Income and profits taxes	$2,839		$2,601[1]	
Munition manufacturers tax	13		—	
Estate tax	47		82	
Corporate capital stock tax	25		29	
Total taxes on wealth		2,924 or 79.1 per cent		2,707 or 70.5 per cent
Distilled spirits	318		365	
Fermented liquors	126		118	
Tobacco	158		206	
Stamp taxes	19		37	
Transportation	71		234	
Insurance	6		15	
Excise taxes	37		78	
Soft drinks	2		7	
Admissions	26		51	
Miscellaneous	8		22	
Total taxes on consumption, transactions, and commodities		$771 or 20 9 per cent		$1,133 or 29.5 per cent
Total		$3,695		$3,840

IV. *The Loans*

With the impossibility of securing more than a comparatively small proportion of the war expenditures from taxation, it became necessary everywhere to resort to borrowing. This was consequently done by all countries on a gigantic scale; although here again the fiscal and economic conditions in the various countries varied so widely that they employed quite diverse expedients.

Great Britain provided at the outset of the war for immediate needs by selling short-time securities, principally treasury bills. Before long, however, these had accumulated to such an extent that it became imperative to issue long-time bonds. Accordingly, subscriptions were invited to the first war loan which was issued in March, 1915, followed in June of the same year by a second war loan. These bore interest at the rate of 3½ per cent and 4½ per cent respectively and the amount issued was 332 and 592 millions sterling or 1,703 and 2,883 million dollars respectively. On February, 1916, an issue of war

[1] As the new taxes were payable in instalments, about 2 billions of the tax really payable for the year 1919 were not received until the fiscal year 1920. Making allowance for this, the proportion of taxes on wealth really ascribable to the year 1919 rises to 80.6 per cent.

savings certificates was inaugurated. In April, 1917, the third war loan was issued at 4.5 per cent, yielding 941 millions sterling, or 4,403 million dollars, followed in June of the same year by an issue of 5 per cent exchequer bonds.

Beginning in October, 1917, a continuous issue of 4 per cent and 5 per cent national war bonds was made, the difference in the rate of interest being due to the tax exemption. The temporary and short-time paper was now gradually funded into these bonds. In the meantime the Anglo-French loan of 500 million dollars, of which England had one-half, had been contracted in the United States; and with the entrance of the United States into the war, continually larger sums were borrowed from the American government. By the end of 1918, as will be seen from Table M, almost 4 billions sterling, or considerably more than one-half of the new debt, was in the form of relatively long-time domestic securities.

France was in a less favorable situation than Great Britain at the outbreak of the war. The total debt of France at the close of 1913 amounted to 32,594 million francs or 6,291 million dollars, and the ordinary budget had closed with a large deficit, so that it had been necessary to issue a loan during the spring and summer of 1914. When the war broke out, precipitating an economic and financial crash, it became practically impossible to issue another loan. The government was therefore compelled to rely upon advances from the Banque de France which was permitted correspondingly to increase its note issue. It was not until November, 1915, that France saw her way to invite subscriptions to her first war loan, which, although bearing interest at the rate of 5 per cent, was issued at the low price of 87¼. This was followed in August, 1916, by the second war loan, also of 5 per cent bonds. In December, 1917, the third war loan was contracted and in 1918 the fourth war loan. In these two latter cases France reverted to her old policy of discount bonds so that the issues fetched the price of only about 70. The nominal subscriptions to the loans were therefore quite different from the actual receipts in cash. Even the nominal sums yielded by these four loans, however, amounted to less than 70 billions of francs, so that the chief reliance of France had to be placed on floating debts like advances from the bank of France, on the so-called national defense bonds, which were issued continuously from February, 1915, and, finally, on the foreign loans contracted in England,

United States, and Japan. The internal loans as a consequence constitute only about 40 per cent of the war debt, a result which is now proving a serious embarrassment in the French program of fiscal reconstruction.

Russia was the first of the Entente Powers to contract public loans. In September, 1914, Russia began with a 5 per cent issue at 94, followed at regular intervals up to the revolution of 1917 by six more loans. At that time about 6 billion dollars had been raised by relatively long-time securities, constituting, however, only a very small part of the entire debt.

Somewhat similar difficulties were experienced by Italy. The pre-war debt of Italy amounted to 13,636 million lire or 2,621 million dollars. Italy started in 1915 with the so-called mobilization loan followed by the first war loan in July, 1915, and by further war loans in January of each of the following years. Every successive loan showed an increase of the interest rate and a decrease of the issue price, thus disclosing the growing fiscal difficulties. The total proceeds of the internal war loans, as appears from Table M, were only about 15 million lire. Italy, therefore, had also to depend primarily upon short-time securities, like treasury bonds and exchequer bills, upon advances from the banks, and upon loans from the Allies. As a matter of fact, less than 30 per cent of the new war debt consists of long-time internal war bonds.

Of the Central Powers, Germany followed a different plan from the outset. She decided to rely at once upon comparatively long-time bonds rather than upon temporary or short-time securities, and for several years prided herself upon her superiority in this respect over Great Britain and France. In October, 1914, a large war loan was issued at 5 per cent. There followed in regular succession eight more war loans bearing 4½ per cent and 5 per cent respectively. During the earlier years of the war, accordingly, the loan situation of Germany must be pronounced to have been more favorable than that of the other belligerents. Toward the end, however, as the difficulties increased, the internal loans did not suffice and Germany, like France and Italy, was now compelled to depend more and more upon a makeshift policy. Nevertheless, by the end of 1918, 98 billion marks out of a total war debt of 153 billions or about 64 per cent of the whole, was in the form of long-time internal bonds. This was a better showing than that of any of the other countries.

TABLE M.—WAR LOANS—(In millions)

	Date	Rate	Issue price	Amount subscribed
Great Britain				£
First war loan......	Mar., 1915	3½	95	332
Second " "	June "	4½	100	592
Third " "	Apr., 1917	4–5	95–100	941
Exchequer bonds......	Mar., 1915	3	"	48
" "	Dec., 1915–Apr., 1917	5	100	516
" "	Oct., 1916	6	"	161
National war bonds...	Oct., 1917–Oct., 1918	4–5	100–100½	372
Total.............				3,962
France				*fr.*
First war loan......	Nov., 1915	5	87¼	15,205 [1]
Second " "	Aug., 1916	"	88¾	11,514 [1]
Third " "	Dec., 1917	4	68.6	14,803 [1]
Fourth " "	" 1918	"	70.8	27,853 [1]
Total.............				69,375 [1]
Italy				*li.*
Mobilization loan.....	Jan., 1915	4½	97	1,000
First war loan......	July "	"	93–95	1,146
Second " "	Jan., 1916	5	97½	3,014
Third " "	" 1917	"	90	3,985
Fourth " "	" 1918	"	86½	6,120
Total.............				15,266
Russia				*ru.*
First war loan......	Sept., 1914	5	94	500
Second " "	Mar., 1915	"	"	500
Third " "	May "	5–5½	99	1,000
Fourth " "	Nov. "	5½	95	1,000
Fifth " "	Feb., 1916	"	"	2,000
Sixth " "	Oct. "	"	"	3,000
Seventh " "	Mar., 1917	5	85	2,500
Total.............				10,500
Germany				*Mk.*
First war loan......	Sept., 194	5	97½	4,480
Second " "	Mar., 1915	"	98½	9,106
Third " "	Sept. "	"	99	12,162
Fourth " "	Mar., 1916	4½–5	95 98½	10,767
Fifth " "	Sept. "	"	95–98	10,699
Sixth " "	Mar., 1917	"	98	12,979
Seventh " "	Sept. "	"	"	12,626
Eighth " "	Mar., 1918	"	"	14,789
Ninth " "	Sept. "	"	"	10,434
Total.............				98,052
United States				$
First liberty loan....	June, 1917	3½	100	2,000
Second " "	Nov. "	4	"	3,908
Third " "	May, 1918	4¼	"	4,177
Fourth " "	Sept. "	"	"	6,989
Victory loan..........	Apr., 1919	4¾	"	5,250
Total.............				22,225

[1] Nominal subscription.

When the United States entered the war it depended for the time being on temporary war certificates. It was, however, soon decided to make a bold appeal to the public, and in June, 1917, subscriptions were invited to the first liberty loan, which was issued at par bearing interest at the rate of 3½ per cent. Although the immense sum of 2 billion dollars was raised by the first loan, still greater efforts were made in the succeeding loans. In November, 1917, the second liberty loan was issued and, despite the original objections of Secretary McAdoo, it was found necessary to raise the rate of interest to 4 per cent. The loan yielded almost 4 billion dollars. In May, 1918, the third liberty loan was issued at 4¼ per cent interest, yielding over 4 billions. The greatest effort was, however, made in January, 1918, when subscriptions were invited to the fourth liberty loan, bearing 4¼ per cent interest, with a result that the unheard of sum of almost 7 billion dollars was subscribed. The last, or victory loan, was issued in April, 1919, bearing 4¾ per cent interest, and yielding about 5¼ billions. The consequence is that almost the entire war debt of the United States consists of relatively long-time and easily manageable domestic securities.[1] In Table M will be found the relevant facts as to the successive war loans of the chief belligerents.

Passing from the problem of long-time versus temporary loans, the final question is that of the total indebtedness of the various belligerents.

In Great Britain it still seems to be a question as to whether and to what extent the loans to the Allies are to be included in the war debt. The Chancellor of the Exchequer, as stated above, thought it prudent to include one-half of the amount. The result is, as shown in Table N, that the British debt which amounted to 650 millions sterling, or 3,115 millions of dollars, just before the war, rose by the close of the fiscal year in 1919 to a total of 7,643 millions sterling or 37,221 millions of dollars. Inasmuch, however, as the Chancellor of the Exchequer asserted in his financial statement of April 30, 1919, that he expected to borrow about 250 millions sterling, or 1,217 millions of dollars, during the year 1919–1920, the debt of Great Britain at the end of the fiscal year 1920 will amount to almost 8 billions

[1] A severe criticism of the government policy of the issue of loan anticipation certificates of indebtedness will be found in J. H. Hollander, *War Borrowing, A Study of Treasury Certificates of Indebtedness of the United States,* 1919.

sterling or about 39 billion dollars. The war debt proper, therefore, at the end of that period may be expected to amount to 7¼ billions sterling or 35 billion dollars.[1]

TABLE N.—PUBLIC DEBT OF GREAT BRITAIN

(In millions)

	Year ending March 31					
	1914	1915	1916	1917	1918	1919
	£	£	£	£	£	£
Funded debt	587	583	318	318	318	318
Terminable annuities	30	28	26	24	22	22
3½ per cent bonds	...	349	63	63	63	63
4½ per cent bonds	...	...	900	20	16	16
4 and 5 per cent bonds	..	...	...	2,119	2,090	2,090
National war bonds	...	..	...	...	649	1,716
Treasury bills	13	77	567	464	473	947
Exchequer bonds	20	67	177	320	392	393
War savings certificates	...	...	1	74	138	227
War expenditure certificates	..	...	...	24	23	...
"Other debts"	...	...	9	317	944	1,345
American loan	...	....	51	51	51	51
Total	650	1,104	2,133	4,011	5,872	7,643 [2]

In France, where the pre-war debt was 32,594 millions of francs or 6,291 millions of dollars, the total debt at the end of 1918 amounted to 167,469 millions or 32,322 millions of dollars, constituting a relatively more crushing burden than that of Great Britain. The war debt proper as will be seen in Table O, amounted to 134,875 millions of francs or 26,031 millions of

[1] The actual figures for March 31, 1920, were as follows: Gross Liabilities £7,875,607,166; Estimated Assets £106,023,346. *Cf. Return on the National Debt. Cf.* Paper 1024 for 1920.

[2] This includes £207 millions of sinking fund premiums, which when deducted would bring the net debt to 7,435 millions.

This total includes the loans to the Allies and Dominions:

(In millions)

Russia	£ 568
France	434
Italy	413
Belgium	87
Serbia	19
Other Allies	48
Total Allies	£1,568
Dominions	171
Total	£1,739

dollars. Inasmuch, however, as it is virtually certain that a considerable sum will still have to be borrowed during 1919 and 1920, the total debt of France directly and indirectly due to the war, will, in all probability amount to a much larger sum.[1]

The high-water mark of the external debt of France was reached on Sept. 30, 1920, when it amounted to 35,328 million gold francs. By Mar. 31, 1921, this had been reduced to 32,723 millions. But the internal debt was growing fast.

TABLE O.—PUBLIC DEBT OF FRANCE, DECEMBER 31, 1918
(In million francs)

Domestic debt			136,874
Funded debt		67,739	
including: 3 per cent rentes	19,746		
5 " " "	25,853		
4 " " "	12,850		
4 " " " of 1918	30,000		
3 and 3½ redeemable	3,118		
Floating debt		49,136	
including: national defense bonds	29,463		
advances from Banque de France	18,000		
Foreign debt			30,595
Funded debt		15,127	
including: advances from U. S. government	12,001		
Anglo-French loan in U. S.	1,376		
other loans from U. S.	1,602		
Japanese loan	147		
Floating debt		15,471	
Total		167,469	=$32,322
Pre-war debt in 1913		32,594	=$ 6,291
War debt		134,875	=$26,031

In Italy the pre-war debt was 13,636 millions of lire. At the end of October, 1918, as will be seen from Table P, the total debt amounted to over 63 millions of lire or somewhat more than 12 billions of dollars, making the war debt proper, about 50 billions of lire or 10 billions of dollars. By the end of May, 1919, the debt had grown to over 77 billions of lire or 15 billions of dollars, and the end is not yet. This represents a very disproportionate burden as compared with the British figures.

For Germany, where the pre-war debt amounted to 4,732 million marks, the figures are not yet entirely complete. Minister Schiffer stated in February, 1919, that the debt had grown by the end of 1918 to 157,700 million marks. But Minister Erzberger stated in his Reichstag speech of October 31, 1919, that the total debt then amounted to 204 billions of marks, which would make the war debt over 199 billions of marks or 47,726 millions of dollars—the largest debt of all the belliger-

[1] *Cf.* the figures for 1921, *infra*, p. 780.

ents. It must be remembered, however, that the great depreciation of the mark during the period when most of the debt was contracted reduces the actual American equivalent considerably.

TABLE P.—PUBLIC DEBT OF ITALY, AUGUST 31, 1918
(In million lire)

Pre-war debt	13,636
War loans	14,737
Treasury bonds	3,052
Exchequer bills	9,240
Foreign advances from England and the United States	13,850
Advances from banks	6,536
Notes issued by the government	2,041
Total	63,093=$12,177
By May 31, 1919, the total debt had increased to	77,768=$15,069

In Austria-Hungary, the pre-war debt was 18,354 million crowns or 3,726 million dollars. In August, 1919, the new Austria which by treaty assumed 70 per cent of the total war debt of the old empire had a war debt composed as follows: war loans, 35 billion crowns; other war debt, 11½ billions; bank notes, 50 billions, or a total of 96½ billions. At the rate of 70 per cent this would make the total war debt of the old empire now divided among various states, 137,858 million crowns or 28,584 million dollars. But the same caution as to the depreciation of the currency must be observed here.

TABLE Q.—PUBLIC DEBT OF THE UNITED STATES
(In millions)

Date			Debt less cash in Treasury
Apr. 15, 1917			$ 1,189
June 30, 1917			1,909
" " 1918			10,924
Oct. 31, 1919 Bonds:			
	Pre-war bonds		$ 883
	First liberty loan	$1,985	
	Second " "	3,526	
	Third " "	3,904	
	Fourth " "	6,614	
			$16,029
	Notes: Victory loan		4,414
	Treasury certificates		3,736
	War-saving certificates		911
	Old debt on which interest has ceased		2
	Non-interest bearing debt		236
	Total gross debt		$26,211
	Cash on hand		888
	Net debt		$25,323

In the United States the total net debt just before the entrance into the war, in April, 1917, was $1,190 millions. This had increased by Oct. 31, 1919, to $25,322 millions, making a war debt of $24,133 millions. The debt, as appears from Table Q, was composed almost wholly of war bonds, together with a relatively small amount of outstanding treasury certificates. Deducting the loans to Allies, the national debt amounts to about 15 billions.

The other countries need not be treated separately. In Table R an attempt is made to present a summary picture of the public debts of all the belligerents. From this table it appears that the total pre-war debt amounted to over 29 billion dollars. On the other hand, the debt at the close of the war, including that of Japan (whose debt was increased only by a part of the funds raised to lend to Great Britain and France), but not including the debt contracted largely for internal and non-war purposes by the Bolshevist government in Russia, amounted to almost 228 billions of dollars. This would make the net debt of the world directly ascribable to the war about 198 billions.[1]

The debt of the former belligerents has in some cases been steadily increasing since the close of the war, notably in France and Germany, and the demands of reparation will lead to further prodigious increase of the German debt. By the beginning of 1921 the total debt of the belligerents had increased to over three hundred billions and the end is not yet. In France alone the debt, just before the issue of the new six per cent loan in the spring of 1921, amounted to 245 billion francs, (almost 50 billions of dollars) or half as much again as the debt at the date of the armistice. Taking the limit, however, of from six months to a year after the armistice, as is done in this chapter the net debt immediately caused by the war and expended primarily for the war itself, amounted, roughly speaking, to about two hundred billions of dollars.

When we compare this figure of 198 billions of the war debt with the total cost of the war, which, as we have seen, amounts to over 210 billion dollars, it appears that well-nigh the entire cost of the war was defrayed from loans. The difference of some 13 billions derived from taxation is due (apart from the slightly different dates utilized for the two computations,

[1] The same caution must here be observed as that mentioned above on p. 757.

TABLE R.—PUBLIC DEBTS OF BELLIGERENTS—(In millions)

	Before the war			After the war			War debt
Great Britain	Aug. 4, 1914	£650=	$ 3,165	Mar. 31, 1919	£7,643 [1]=	$ 37,221	$ 34,056
Australia	June 30, "	19=	93	Jan. " "	336=	1,634	1,541
Canada	Mar. 31, "		332	Aug. " "		1,684	1,352
New Zealand	" " "	92=	448	Mar. " "	170 =	828	380
South Africa	" " "	126=	614	" " "	175 =	846	232
India		307=	1,465	" " "		1,968	493
British Empire			$ 6,117			$ 44,181	$ 37,034
France	July, 1914	fr. 32,594=	$ 6,291	Dec. 31, 1918	fr. 167,459 =	$ 32,322	$ 26,031
Russia	" "	ru. 8,800=	4,623	Sept. 1, 1917	ru. 49,288 [2]=	25,383	20,760
Italy	May, 1915	li. 13,636=	2,621	May 31, 1919	li. 77,763 =	15,009	12,388
Belgium	Aug. 2, 1914	fr. 3,743=	722	Apr. 30, 1919	fr. 9,787 =	1,888	1,166
Rumania	Aug., 1916		292	Oct. 31, 1918		1,020	728
Serbia	July, 1914		271	" " "		730	459
Greece			238	May 31, 1919		601	363
Japan	July, 1914	yen 2,494=	1,247	July 31, 1918	yen 2,530 =	1,265	18
United States	Apr. 5, 1917		1,190	June 30, 1919		25,322	24,133
Entente Powers			$23,612			$147,701	$123,077
Germany	Aug. 1, 1914	mk. 4,732=	$ 1,126	Oct. 30, 1919	mk. 204,000 =	$ 48,552	47,426
Austria-Hungary	" "	kr. 18,354=	3,726	July 31, "	kr. 137,858 =	28,584 [3]	24,858
Turkey	Nov., "	LT. 112=	485	Oct. " 1918	LT. 455 =	2,002	1,517
Bulgaria	Oct. 4, 1915		219	" " "		974	755
Central Powers			$5,556			$ 80,112	$ 74,556
Total			$29,163			$227,813	$197,633

[1] Counting on repayment of one-half of the loans to the Allies (£816 millions).
[2] The additional debt contracted by the Bolshevist government is not included.
[3] Obtained by considering the debt of the new Austria as representing 70 per cent of the debt of all the states which constituted the old empire.

and which are responsible for two or three billions) almost wholly to the efforts of Great Britain and the United States, the former raising about 7 and the latter about 7½ billions from taxation—Great Britain in a little over four and a half years, the United States in a little over two years. While a few billions additional were raised from taxation, as we have learned, by Italy and Germany, their contributions to the expenditures were more than counterbalanced by the budget deficits in those states, as well as in France. It remains true, therefore, that the war was conducted almost entirely on credit. The outstanding problem now confronting every country, victorious and conquered alike, is how to secure the funds needed to defray the interest and to provide for the amortization of these gigantic debts, which offset a not insignificant part of the entire wealth of the world.

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